CERTIFICATE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1925

No. 265

KANSAS CITY TERMINAL RAILWAY COMPANY ET AL.

vs.

CENTRAL UNION TRUST COMPANY OF NEW YORK ET AL.

ON CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

FILED FEBRUARY 2, 1925

(30,846)

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JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., AUGUST 31, 1925

[fol. 1] **IN UNITED STATES CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT**

No. 6457

KANSAS CITY TERMINAL RAILWAY COMPANY et al., Appellants,

vs.

CENTRAL UNION TRUST COMPANY OF NEW YORK et al., Appellees

Appeal from the District Court of the United States for the Eastern District of Missouri

Amended Certificate—Filed April 25, 1925

STATEMENT OF FACTS

This amended certificate is presented, in lieu of the certificate heretofore filed, in order that certain additional facts (deemed by the parties and this court of use in determining the questions herein submitted) might be brought to the attention of the court.

The United States Circuit Court of Appeals for the Eighth Circuit hereby certifies that a record on an appeal now pending before it discloses the following:

The Kansas City Terminal Railway Company and others filed an intervening petition in the receivership proceedings of the Missouri, Kansas & Texas Railway Company. That intervention sought to attach the obligations of passenger terminal contracts to the property in such a way that the obligations of these contracts would be either a lien on the property prior to all mortgage obligations or would follow the property into the hands of any purchaser under foreclosure of the mortgages. It was determined by the district court and affirmed by this court (294 Fed. 32) that these terminal contracts were ordinary executory contracts entered into by the Missouri, Kansas & Texas Railway Company as aids to its operation.

Thereafter, the property in receivership was sold under foreclosure. The purchase was in pursuance of a re-organization plan. This plan involved lien holders, unsecured creditors and stockholders. In [fol. 2] so far as the plan affects lien holders it is not involved in this appeal. The points raised on this appeal relate to the fairness of the offer to these interveners which were classed as unsecured creditors. This plan was not submitted to the court but the offer to unsecured creditors, as contained therein, was submitted and approved. Their claim is that the stockholders were unduly preferred in this re-organization plan.

By the re-organization plan the new company was to have four classes of securities as follows:

Prior Lien Mortgage Bonds (authorized issue $250,000,000),

Cumulative Adjustment Mortgage Bonds (authorized issue $100,000,000) which were income bonds secured by mortgage as to principal,

Preferred Stock (authorized issue $200,000,000),

Common Stock without par value (authorized issue 2,500,000 shares).

Of the above securities, certain amounts of each were reserved for future use by the new company. Of the prior lien bonds provided for distribution in the plan, some bore interest at four per cent, some at five per cent and some at six per cent respectively.

Under the re-organization plan new securities were offered to the holders of seventeen separate issues of outstanding bonds of the Missouri, Kansas & Texas Railway Company and its various subsidiary companies secured by mortgage and of one issue of notes secured by the pledge of mortgage bonds. In some cases, but not in all, cash was offered to the holders of these secured claims in addition to new securities. In all cases the par amount of the new securities offered (taking the new non par value common stock at $100 per share) plus the cash offered, if any, equalled, and in no case did it exceed, the principal amount of the old outstanding securities in respect of which the offer was made plus the unpaid interest thereon up to January 1, 1922.

Of said eighteen outstanding issues

Five issues were offered only New Prior Lien Bonds and cash,

One issue was offered only New Prior Lien Bonds,

Five issues were offered only New Prior Lien Bonds and New Adjustment Bonds,

Three issues were offered only New Prior Lien Bonds, New Adjustment Bonds and New Preferred Stock,

One issue was offered only New Adjustment Bonds and New Preferred Stock,

[fol. 3] Three issues were offered only New Adjustment Bonds, New Preferred Stock and New Common Stock.

In all cases the New Prior Lien Bonds and the New Adjustment Bonds (whether offered to secured creditors, unsecured creditors or stockholders) were to bear interest from January 1, 1922.

In so far as the re-organization plan affected stockholders and unsecured creditors its provisions were substantially as follows:

(1) Preferred stockholders were entitled to receive $14 in Prior Lien Bonds (bearing six per cent interest), $6 in Adjustment Bonds and one share of Common Stock in the new company upon payment of $20 for each share of stock of the par value of $100 held in the old company; (2) Common stockholders were entitled to receive $17.50 in Prior Lien Mortgage Bonds (bearing six per cent interest), $7.50 in Adjustment Bonds and one share of Common Stock upon payment of $25 for each share of stock of the par value of $100 held in the old company; (3) Unsecured creditors were given the choice of two plans: (a) one-third of a share of Preferred Stock of the par value of $100 and two-thirds of a share of Common Stock without par value for each $100 of the aggregate amount of the claim, in-

cluding interest to January 1, 1922, whereas the receiver was appointed and took possession of the property on September 27, 1915, the foreclosure decree was entered on June 30, 1922, the offer to creditors was dated July 15, 1922, the foreclosure sale was had on December 13, 1922, the order confirming the sale was entered February 9, 1923, and the order approving the Master's deed conveying the property to the new company was entered on March 10, 1923; (b) $14 in Prior Lien Mortgage six per cent bonds, $6 in Adjustment Mortgage Bonds and one share of Common Stock upon payment of $18 for each $100 of said claim.

A claim made by appellants here is that certain decisions of the Supreme Court of the United States (Northern Pacific Railway Company v. Boyd, 228 U. S. 482; Louisville Trust Company v. Louisville Railway Company, 174 U. S. 674) require that an offer in a re-organization plan, in order to be a fair and binding offer upon the creditor must be one which will preserve "to the creditor, his rela-[fol. 4] tive priority over the stockholder. It is not sufficient that he should get a little more than the stockholder. His entire claim must take precedence over any part of the interest of a stockholder. It is not sufficient that he be offered securities of the same grade as the stockholder but a trifle more in amount, or that the stockholder's right to participate be conditioned upon the payment of an assessment."

Questions Certified

It is further certified that the following questions of law arise from this record and are presented, the decision of which is indispensable to a determination of the case. To the end that this court may properly discharge its duty it desires the instruction of the Supreme Court upon them.

Question I. Is a plan of re-organization of a railway company sufficient as to unsecured creditors and binding upon them which does not give precedence to the entire claim of the creditor over any part or interest of a stockholder in the old company?

Question II. Is such a plan fair and binding upon such creditors even though they be offered securities of the same grade as the stockholders, the difference being only in the greater amount offered the creditors, provided the court shall be of the opinion that the offer tenders to such creditors all that could reasonably be expected under all of the existing circumstances?

Question III. Is such offer as to such creditors fair and binding if it consists only of the same grade of securities as offered the stockholders, the difference being that the right of the stockholders to participate is conditioned upon the payment of an assessment or the payment of a relatively greater assessment than that asked of such creditors, provided the court shall be of the opinion that the offer

tenders to such creditor all that could reasonably be expected under [fol. 5] all of the existing circumstances?

Kimbrough Stone, United States Circuit Judge; William S. Kenyon, United States Circuit Judge; C. B. Faris, United States District Judge, Being the Judges who sat in the Circuit Court of Appeals on the Hearing of the Case.

[fol. 6] IN UNITED STATES CIRCUIT COURT OF APPEALS

CLERK'S CERTIFICATE

I, E. E. Koch, Clerk of the United States Circuit Court of Appeals for the Eighth Circuit, do hereby certify that the foregoing Amended Certificate in the case of Kansas City Terminal Railway Company, et al., Appellants, vs. Central Union Trust Company of New York, et al., Appellees, No. 6457, was duly filed and entered of record in my office by order of said Court, and as directed by said Court, the said certificate is by me transmitted to the Supreme Court of the United States for its action thereon.

In testimony whereof, I hereunto subscribe my name and affix the seal of the United States Circuit Court of Appeals for the Eighth Circuit, at office in the City of St. Louis, Missouri, this twenty-third day of April, A. D. 1925.

E. E. Koch, Clerk of the United States Circuit Court of Appeals for the Eighth Circuit. (Seal of the United States Circuit Court of Appeals, Eighth Circuit.)

[Endorsed:] U. S. Circuit Court of Appeals, Eighth Circuit. No. 6457. Kansas City Terminal Railway Company et al., Appellants, vs. Central Union Trust Company of New York et al. Amended certificate of questions to the Supreme Court of the United States. Filed Apr. 23, 1925. E. E. Koch, clerk.

DENIED MAY 4 - 1925

APR 25 [illegible]
WM. R. STANS[illegible]

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, [redacted] 192[illegible]

No. [redacted] 285

KANSAS CITY TERMINAL RAILWAY COMPANY ET AL.

vs.

CENTRAL UNION TRUST COMPANY OF NEW YORK, TRUSTEE, ET AL.

MOTION TO BRING UP ENTIRE RECORD AND CAUSE.

EDWARD J. WHITE,
N. H. LOOMIS,
BRUCE SCOTT,
GARDINER LATHROP,
SAMUEL W. SAWYER,
Counsel for Kansas City Terminal Railway Company et al.

H. H. FIELD,
W. F. DICKINSON,
N. S. BROWN,
F. H. MOORE,
Of Counsel.

IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1924.

Kansas City Terminal Railway Company, Illinois Trust & Savings Bank, Charles G. Hutcheson, The Atchison, Topeka and Santa Fe Railway Company, Chicago, Milwaukee & St. Paul Railway Company, Union Pacific Railroad Company, Chicago, Burlington and Quincy Railroad Company, The Kansas City Southern Railway Company, Wabash Railway Company, The Chicago, Rock Island and Pacific Railway Company, and Missouri Pacific Railroad Company, Petitioners,

VS.

Central Union Trust Company of New York, Trustee under the Consolidated Mortgage of Missouri, Kansas and Texas Railway Company, Central Union Trust Company of New York, Trustee under the Trust Agreement securing the two-year notes of Missouri, Kansas & Texas Railway Company, The Farmers' Loan & Trust Company, Trustee under the First and Refunding Mortgage of Missouri, Kansas & Texas Railway Company, The New York Trust Company, Trustee under General Mortgage of Missouri, Kansas & Texas Railway Company, B. F. Edwards, Trustee under General Mortgage of Missouri, Kansas & Texas Railway Company, Bankers Trust Company, Trustee under Second Mortgage of Missouri, Kansas & Texas Railway Company, Columbia Trust Company, Trustee under the First Mortgage of The Missouri, Kansas & Eastern Railway Company, Central Union Trust Company of New York, Trustee under Second Mortgage of Missouri, Kansas & Eastern Railway Company, The Farmers' Loan & Trust Company, Trustee under the St. Louis Division Refunding First Mortgage of the Missouri, Kansas & Texas Railway Company, Central Union Trust Company of New York, Trustee under First Extension Mortgage of Missouri, Kansas & Texas Railway Company, the Farmers' Loan & Trust Company, Trustee under Southwestern Coal & Improvement Company First Mortgage, Missouri-Kansas-Texas Railroad Company, Francis F. Randolph and Hugo W. Blumenthal, Respondents.

PETITION FOR WRIT OF CERTIORARI.

To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

Your petitioners, Kansas City Terminal Railway Company, Illinois Trust & Savings Bank, Charles G. Hutcheson, The Atchison, Topeka and Santa Fe Railway Company, Chicago, Milwaukee & St. Paul Railway Company, Union Pacific Railroad Company, Chicago, Burlington and Quincy Railroad Company, The Kansas City Southern Railway Company, Wabash Railway Company, The Chicago, Rock Island and Pacific Railway Company and Missouri Pacific Railroad Company, respectfully show as grounds for the issuance of a writ of certiorari to the United States Circuit Court of Appeals for the Eighth Circuit:

The United States Circuit Court of Appeals for the Eighth Circuit, by an order dated January 22, 1925, in a cause then pending before it, certified to this court three questions or propositions of law, concerning which it desired the instruction of this court for their proper decision.

The cause in which the questions arose was entitled *"Kansas City Terminal Railway Company, et al., Appellants,* v. *Central Union Trust Company of New York, et al., Appellees, No.* 6457."

The questions certified were as follows:

> Question I. Is a plan of reorganization of a railway company sufficient as to unsecured creditors and binding upon them which does not give

precedence to the entire claim of the creditor over any part or interest of a stockholder in the old company?

Question II. Is such a plan fair and binding upon such creditors even though they be offered securities of the same grade as the stockholders, the difference being only in the greater amount offered the creditor, provided the court shall be of the opinion that the offer tenders to such creditor all that could reasonably be expected under all of the existing circumstances?

Question III. Is such offer as to such creditors fair and binding if it consists only of the same grade of securities as offered the stockholders, the difference being that the right of the stockholder to participate is conditioned upon the payment of an assessment or the payment of a relatively greater assessment than that asked of such creditors, provided the court shall be of the opinion that the offer tenders to such creditor all that could reasonably be expected under all of the existing circumstances?

A copy of the certificate of the Circuit Court of Appeals is attached as an appendix.

The certificate was docketed in this court on the 2nd day of February, 1925, as No. 881, October Term, 1924.

This petition is in the nature of an application that the whole record and cause may be sent up to this court for its consideration in accordance with Section 239 of the Judicial Code and Rule 37 of the Rules of this court. There is furnished herewith as required by the statute and the rules of this court a certified copy of the entire transcript of the record in the case.

The reasons for this petition or application are two: (1) The public importance of the questions requires an authoritative disposition of them. Such a disposition can be made by this court with greater convenience to itself and with more satisfactory results by a decision based upon the specific facts in the record than is possible by theoretical answers based upon assumed facts which are necessarily incomplete. (2) Another important question not certified by the Circuit Court of Appeals is involved in the case. It could not have been certified by the Circuit Court of Appeals without detailing substantially all of the facts in the record and thus virtually calling upon this court for a determination of the whole case. It was, perhaps, for this reason that the question was not certified. The question is of dignity and importance comparable with the dignity and importance of those certified, however, and should be considered and disposed of by this court. The nature of the question and the manner in which it arises will be made clear in the brief filed herewith.

Wherefore, your petitioners respectfully pray that a writ of certiorari may be issued out of and under the seal of this court directed to the United States Circuit Court of Appeals for the Eighth Circuit, commanding the said court to certify and send to this court a full and complete transcript of the record and all the proceedings in the said Circuit Court of Appeals in the said cause therein entitled, *"Kansas City Terminal Rail-*

way Company, et al., Appellants, v. *Central Union Trust Company of New York, Trustee, et al., Appellees, No. 6457,*" to the end that this court may decide the whole matter in controversy in the same manner as if it had been brought to this court for review by writ of error or appeal—all as provided in Section 239 of the Judicial Code and Rule 37 of the Rules of this court.

EDWARD J. WHITE,
N. H. LOOMIS,
BRUCE SCOTT,
GARDINER LATHROP,
SAMUEL W. SAWYER,
Counsel for Petitioners.

H. H. FIELD,
W. F. DICKINSON,
N. S. BROWN,
F. H. MOORE,
Of Counsel.

State of Missouri, County of Jackson, ss.

Samuel W. Sawyer, being duly sworn, on his oath says, that he is one of counsel for petitioners and that the facts stated in the foregoing petition are true to the best of his knowledge and belief.

Samuel W. Sawyer.

Subscribed and sworn to before me this 7th day of April, 1925.

My term expires June 14, 1927.

(Seal) Kittie Kilburn,
Notary Public.

The foregoing petition or motion is in my opinion well founded in law and is not interposed for delay.

SAMUEL W. SAWYER,
Of Counsel for Petitioners.

IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1924.

KANSAS CITY TERMINAL RAILWAY COMPANY ET AL., PETITIONERS,

VS.

CENTRAL UNION TRUST COMPANY OF NEW YORK, TRUSTEE, ET AL., RESPONDENTS.

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI.

STATEMENT.

In the consolidated receivership and foreclosure suits in the United States District Court for the Eastern District of Missouri growing out of the financial troubles of the Missouri, Kansas & Texas Railway Company, the petitioners filed an intervening petition in which they claimed that certain 200-year contracts to which they were parties with the Missouri, Kansas & Texas Railway Company, providing for the joint operation of the union passenger station and a large system of terminal facilities in Kansas City, Missouri, were, by reason of their character and the circumstances of their execution, entitled to priority over the mortgages of the Missouri, Kansas & Texas Railway Company.

The relief prayed by this intervention was denied by the District Court and the decree was affirmed by the Circuit Court of Appeals for the Eighth Circuit (*Kansas City Terminal Railway Company, et al.*, v. *Central Union Trust Company, et al.*, 294 Fed. 32), and a writ of certiorari was denied by this court (264 U. S. 588).

Subsequently, the property was sold under the foreclosure decree. The purchasers bought in pursuance of a re-organization plan, which provided for the acquisition of the property by a new corporation in whose securities the stockholders, both preferred and common, of the old Missouri, Kansas & Texas Railway Company were to share upon terms provided in the plan. The foreclosure decree provided that any corporation which might become the purchaser and in which the stockholders of the old company were to have any interest must file with the Master proof of an offer of participation to creditors. The new Missouri-Kansas-Texas Railroad Company, which became the purchaser of the property, filed proof of a general offer to creditors.

Upon motion to confirm the sale, the appellants objected to the confirmation of the sale on the ground that the offer to creditors made by the new company was not fair and adequate under the decision of this court in *Northern Pacific Railroad Co.* v. *Boyd*, 228 U. S. 482, and, even if fair and adequate as to creditors generally, was not appropriate to the petitioners' claims, and was not fair and adequate as to them. The petitioners' objections were overruled by the District Court and the sale was confirmed. The petitioners appealed to the Cir-

cuit Court of Appeals for the Eighth Circuit and, after argument there, the certificate of questions referred to was issued by that court.

I.

The importance and breadth of the questions make a decision of the entire case on a full record desirable.

It is unnecessary to emphasize the importance of the questions. They are of similar character to the questions previously before this court in *Louisville Trust Co.* v. *Louisville, etc. Ry. Co.*, 174 U. S. 674; *Northern Pacific Railroad Co.* v. *Boyd*, 228 U. S. 482; *Kansas City Southern Railway Company* v. *Guardian Trust Company*, 240 U. S. 166. The considerations involved are similar in some respects to those involved in the case of *St. Louis Company* v. *Wabash Railroad Company*, 217 U. S. 227, where this court in assuming jurisdiction on writ of certiorari, says:

> "It is not a question of the payment of money, but of the extent of the use belonging to one railroad company in the tracks, right of way and terminal facilities of another, as well as the rights of access by the one company to industries established along the line of the other. This, in view of the increasing number of industries in a great and growing city like St. Louis, is of constantly enlarging importance, and ought, so far as possible, to be settled. It seems to us that both the private interests of the railroad companies, and of the separate industries and the *greater interests of the public call for the granting of the writ of certiorari* and it is, therefore, so ordered."

In the Boyd case, this court determined that a stockholders' organization could not stand unless a fair offer to creditors was made, but, as no offer at all had been made in that case, it was not necessary for this court to determine finally what could constitute a fair offer, though the court used language which might serve as a guide in subsequent cases.

The case at bar requires a definite determination as to whether an offer actually made is a fair and adequate offer. It is highly desirable that, in the determination of this question, an authoritative rule should be laid down by which the participants in future reorganizations may determine what is necessary to constitute a fair offer and, consequently, what is the measure of their respective rights. The record in this case furnishes a thoroughly adequate background for the determination of this question and the enunciation of principles which may be of inestimable benefit in future reorganizations.

The questions certified by the Circuit Court of Appeals have been very carefully framed and are of such a character that they can be answered as theoretical questions or propositions of law and without reference to other facts than those certified by the Circuit Court of Appeals. We do not believe, however, that such a determination of the questions will be as satisfactory to this court as would the consideration of the issues in their practical as well as theoretical aspects, and we do not believe that this court, by merely answering the questions, can lay down guiding principles with the

same degree of clearness as by deciding the whole case upon the entire record.

The oral evidence in the record is brief and the documents which have to be carefully considered are comparatively few. Most of the record consists of documents which had to be in the record for purposes of reference and for proof of their own existence, but whose contents need little, if any, consideration. Consequently, to examine all pertinent parts of the record will consume but a small amount of the court's time and we are confident that an understanding of the facts will be of such great assistance in determining the questions involved that on the whole the labors of the court will be lightened if it orders the entire record sent up.

II.

An additional important question not certified arises in the case.

The other questions in the case are (1), whether the offer was so framed as to be applicable to the petitioners and their contracts and therefore whether any offer was really made to these petitioners; (2), whether the offer, if made to the petitioners, and, even if fair as to creditors generally, was fair and adequate as to these petitioners and their contracts.

The first of these questions, of course, relates to the form of the offer and therefore is perhaps not of sufficient public importance to call for an exercise of this court's extraordinary powers. The second question, however, is of great public importance, and ought to be

determined, since the validity of many future railroad re-organizations may depend upon the answer. Our position is that an offer to settle on the basis of an attempted liquidation of damages under a 200-year operating contract or railroad lease, the damages for breach of which are not susceptible of accurate ascertainment, is not a fair and equitable offer to the obligee of such a contract, however fair it may be as to ordinary commercial creditors.

It has been frequently held that terminal and trackage contracts are specifically enforcible in equity, either at the instance of the lessor or of the lessee (using the terms "lessor" and "lessee" in a non-technical sense). See *Pennsylvania Railroad Company* v. *St. Louis-Alton Railroad Company*, 118 U. S. 290; *Grand Trunk Railway Company* v. *Chicago Railroad Company*, 141 Fed. 785; *Prospect Park Railroad Company* v. *Coney Island Railroad Company*, 144 N. Y. 152; *Schmidt* v. *Railway Company*, 101 Ky. 441, 41 S. W. 1015; *Southern Railway Company* v. *Franklin Railway Company*, 96 Va. 698, 32 S. E. 485; *Joy* v. *St. Louis*, 138 U. S. 1; *Chicago Railway Company* v. *Denver Railroad Company*, 143 U. S. 596; *Telegraph Company* v. *Harrison*, 145 U. S. 459; *Union Pacific Railway Company* v. *Railway Company*, 163 U. S. 564; *Central Trust Company* v. *Wabash Railway Company*, 29 Fed. 546; *Union Pacific Railway Company* v. *Railway Company*, 128 Fed. 230; *South Railroad Company* v. *Highland Railroad Company*, 117 Ala. 395, 23 Southern, 973; *Louisville Railway Company* v. *Railway Company*, 92 Tenn. 681, 22

S. W. 920; *Great Northern Railway Company* v. *Manchester Railway Company*, 5 DeGex & Smale, 138; *Wolverhampton Railway Company* v. *London Railway Company*, L. R. 16 Eq. 433.

These cases are based on the impossibility of adequately measuring the damages and also on the public interest involved. It is plain that, if a corporation bound by such a contract undertook to relieve itself of liability by conveying all of its property to another corporation composed of the same stockholders, its attempt would be unsuccessful. It is equally plain that it could not, by such conveyance, relegate the obligee of the contract to an action at law against the new corporation. Where, as here, there is a stockholders' re-organization which "instead of being effectuated by a private sale is consummated by a Masters' deed under a consent decree," the situation is precisely the same, with the single qualification that the new company may relieve itself of liability by making a fair offer to the obligee of the contract.

But the offer must be fair *as to the obligee of the contract*. It is not enough that it is fair as to other people. (*Pierce* v. *United States*, 255 U. S. 398, 403; *Howard* v. *Maxwell Motor Co.*, 269 Fed. 292, 304, 306, 275 Fed. 53.) To be fair to the obligee of such a contract as we have here, it must be an offer which gives the obligee some certain and definite benefit which has priority over the benefits received by the stockholders. An offer which requires the conversion of all rights under such a contract into money damages does not meet

this requirement. Any attempt to liquidate the damages payable by reason of the violation of the contracts here involved will result in the determination of a sum which may prove to be grossly erroneous in the light of subsequent events during the continuance of the contracts. The rights of the appellants under the contracts are not susceptible of liquidation except by a process of inferences which is bound to produce inequitable results. If an attempt were made to liquidate the claim of the Terminal Company, the claim would take the shape of the right to compensation for certain facilities and certain service furnished by the Terminal Company. The extent of the facilities to be furnished and of the service to be rendered, and, consequently, the compensation payable therefor, cannot be determined at the present time. The extent of the use of the property by the MKT Company may increase several hundred per cent or it may diminish. The compensation payable will likewise be increased or diminished. The number of companies using the Terminal Company's facilities may increase or diminish, in which event the compensation payable by the MKT Company would decrease or increase. It is thus difficult, if not impossible, to liquidate the claim in any such way as to fairly compensate the petitioners, even if the full amount so determined were payable in cash.

An offer of preferred stock or income bonds to creditors whose claims are susceptible of measurement or liquidation, if adequate, is, of course, fair and equitable, but an offer of stock or income bonds to obligees

of contracts whose claims are not susceptible of measurement or ascertainment is clearly inappropriate and, therefore, not fair and equitable.

To state the proposition in another form. The re-organization managers, with the consent and approval of the court, gave to the stockholders of the old company a certain part of the value of the property of the Missouri, Kansas & Texas Company which in equity belongs to the creditors and to the obligees of the contracts. The property, therefore, to which the appellants, as obligees of the contracts, have a right to look for the satisfaction of their rights against the Missouri, Kansas & Texas Company (and to which the stockholders have no right as against them), is taken *by a court of equity* from the parties so entitled to it and given to the parties which have no right to it. This obligates the court to give to the appellants at least their share of the property thus diverted. The doctrine requiring fair offers to creditors is only a *means* devised by equity to restore to the creditors and the obligees of the contracts what the court itself has thus by its own action diverted from them.

In the case of ordinary creditors, whose claims are subject to liquidation, an offer to settle on the basis of the liquidation of the claims is doubtless an appropriate means, but the nature of the offer required must vary with the character of the situation, and, where the only offer is of a form inappropriate to restore to the obligees of the contracts the equity taken from them and given to the stockholders, then the justification for the offer

does not exist and the situation is precisely the same as if the corporation had voluntarily transferred its assets to a new corporation organized among its own stockholders for the purpose of receiving them. (*Pierce* v. *United States,* 255 U. S. 398.)

That the service contemplated by these contracts is desirable and even essential to the new company and to the public is thus stated by the Circuit Court of Appeals in the former case:

> "The use of these Terminal facilities is so patently for the benefit both of the public and of all railroads entering Kansas City, that it is difficult to conceive that any such railroad would ever actually cease to use such facilities" (294 Fed. l. c. 39.)

That the interest of the public is the paramount consideration in a court of equity in matters affecting railroads, is shown by the cases of *Joy* v. *St. Louis,* 138 U. S. L., and *Chicago, Rock Island & Pacific Railway* v. *Union Pacific Railway Company,* 47 Fed. 15.

The interest of the public being paramount and it being apparently conceded by both the new company and by the Circuit Court of Appeals that that interest requires the use of these facilities by the new company, it follows that a court of equity, in determining what is a fair offer to the obligees of the contracts covering the use of these facilities, must take that public interest into consideration. The public interest is wholly ignored by an offer which contemplates an attempted liquidation of the contracts and (so far as the court is concerned) a complete abandonment of the facilities. No offer could

give due regard to the public interest unless it provided for the continuance of the use of these facilities (whose use is conceded to be of paramount public importance).

The object of the offer being to work substantial justice, is it not fairly clear that to attain its object the offer to obligees of contracts such as here involved must tender alternative benefits: (1) the performance of the main objects of the contracts either upon the terms provided in the contracts or (if there is anything inequitable in the contracts in the opinion of the court) upon just and equitable terms to be approved by the court, or, at the option of the offeree, (2) ascertainment of the damages for breach of the contracts and participation in the securities of the purchasing corporation upon the same terms as commercial creditors?

We have said enough to illustrate the character and importance of the question. A more elaborate argument is not appropriate here.

It may be that the court will desire to hear the arguments on the questions certified before determining whether the entire record should be sent up, as was done in *Northern Pacific Railway Company* v. *Walker*, 148 U. S. 391; *Shaw* v. *Kellogg*, 170 U. S. 312; *Sigafus* v. *Porter*, 179 U. S. 116; *Brunswick Co.* v. *National Bank*, 192 U. S. 386, and we have no objection to that course; but from our knowledge of the case we feel

certain the court will, at some time, conclude that a decision of the whole case is desirable, and we, therefore, respectfully submit that this petition should be granted.

EDWARD J. WHITE,
N. H. LOOMIS,
BRUCE SCOTT,
GARDINER LATHROP,
SAMUEL W. SAWYER,
Counsel for Petitioners.

H. H. FIELD,
W. F. DICKINSON,
N. S. BROWN,
F. H. MOORE,
Of Counsel.

Office Supreme Court, U. S.
FILED
FEB 12 1926
WM. R. STANSBURY
CLERK

No. 265.

Supreme Court of the United States

OCTOBER TERM, 1925.

KANSAS CITY TERMINAL RAILWAY COMPANY, ET AL.,

VS.

CENTRAL UNION TRUST COMPANY OF NEW YORK, ET AL.

ON CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

BRIEF OF KANSAS CITY TERMINAL RAILWAY COMPANY, ET AL.

EDWARD J. WHITE,
N. H. LOOMIS,
BRUCE SCOTT,
GARDINER LATHROP,
SAMUEL W. SAWYER,
Counsel for Kansas City Terminal Railway Company, et al.

No. 265.

Supreme Court of the United States

OCTOBER TERM, 1925.

KANSAS CITY TERMINAL RAILWAY COMPANY, ET AL.,

VS.

CENTRAL UNION TRUST COMPANY OF NEW YORK, ET AL.

ON CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

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No. 265.

Supreme Court of the United States

OCTOBER TERM, 1925.

KANSAS CITY TERMINAL RAILWAY COMPANY, ET AL.,

VS.

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ON CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

OPINIONS IN THE COURTS BELOW.

There is no reported opinion of either of the courts below. An opinion of the United States Circuit Court of Appeals for the Eighth Circuit on a former appeal involving a different question is reported as *Kansas City Terminal Railway Company et al.* v. *Central Union Trust Company of New York et al.*, 294 Federal 32.

GROUNDS OF JURISDICTION.

The ground of jurisdiction is a certificate of questions or propositions of law certified to this Court by the United States Circuit Court of Appeals for the Eighth Circuit, in accordance with Section 239 of the Judicial Code and Rule 37 of the Rules of this Court promulgated December 22, 1911 (now Rule 34). The original certificate was filed in this Court on February 2, 1925, but it was afterwards amended by the Circuit Court of Appeals, and the amended certificate was filed in this Court on April 25, 1925. The statutory provision under which jurisdiction is invoked is Section 239 of the Judicial Code. The following cases are believed to sustain the jurisdiction of this Court:

Lau Ow Bew, Petitioner, 141 U. S. 583, 144 U. S. 47, 58.

Hertz v. *Woodman*, 218 U. S. 205.

Stratton's Independence v. *Howbert*, 231 U. S. 399.

United States v. *Mayer*, 235 U. S. 55.

STATEMENT OF THE CASE.

The questions certified by the Circuit Court of Appeals are intended to present for this Court's determination what kind of offer to general creditors (in its relation to the provision made for stockholders of the old company in a railroad reorganization plan) is necessary in order to comply with the rule laid down by this Court in *Northern Pacific Railway Company* v. *Boyd*, 228 U. S. 482 (hereafter called the "Boyd case").

The questions certified are as follows:

> QUESTION I. Is a plan of reorganization of a railway company sufficient as to unsecured creditors and binding upon them which does not give precedence to the entire claim of the creditor over any part or interest of a stockholder in the old company?
>
> QUESTION II. Is such a plan fair and binding upon such creditors even though they be offered securities of the same grade as the stockholders, the difference being only in the greater amount offered the creditors, provided the court shall be of the opinion that the offer tenders to such creditors all that could reasonably be expected under all of the existing circumstances?
>
> QUESTION III. Is such offer as to such creditors fair and binding if it consists only of the same grade of securities as offered the stockholders, the difference being that the right of the stockholders to participate is conditioned upon the payment of an assessment or the payment of a relatively greater assessment than that asked of such creditors, provided the court shall be of the opinion that the offer tenders to such creditor all that could reasonably be expected under all of the existing circumstances? (Certificate, p. 3.)

The nature of the cause and the facts on which the questions of law arise are set out in the amended certificate, as required by the rules of this Court. Those deemed immediately pertinent will be here stated. Opposing counsel will doubtless refer to others which they deem pertinent.

In a receivership and foreclosure suit involving the Missouri, Kansas & Texas Railway Company, these appellants filed an intervention in which they asserted priority over the M. K. & T. mortgages for certain contracts to which they were parties. Priority was denied by the District Court and its order in that respect affirmed by the United States Circuit Court of Appeals for the Eighth Circuit (*Kansas City Terminal Railway Company et al.* v. *Central Union Trust Company of New York et al.*, 294 Fed. 32). A foreclosure sale followed, at which the property was purchased for the benefit of a reorganized company formed under a re-organization plan. As stated in the certificate: "The purchase was in pursuance of a reorganization plan." The stockholders of the old company were participants in the plan. The plan provided (1) that holders of preferred stock of the old company should receive $14 in Prior Lien Bonds (bearing six per cent interest), $6 in Cumulative Adjustment Mortgage Bonds (which were income bonds secured by mortgage as to principal), and one share of common stock in the new company, upon payment of $20 for each share of stock of the par value of $100 held in the old company, and (2) that holders of the common stock of the old company should receive $17.50 in Prior Lien Six Per Cent Bonds, $7.50 in

Adjustment Bonds and one share of common stock, upon payment of $25 for each share of stock of the par value of $100 held in the old company (Certificate, p. 2).

It will thus be seen that the stockholders of the old company received share for share in stock, but upon condition that they should take and pay for at par a certain amount of bonds—at the rate of $20 for each share of preferred stock in the old company and $25 for each share of common stock.

The offer made to unsecured creditors was in the alternative, and we will refer to the alternatives as Offer A and Offer B.

Offer A tendered one-third of a share of preferred stock of the par value of $100 and two-thirds of a share of common stock for each $100 of the aggregate amount of the claim (including interest to January 1st, 1922) (Certificate, p. 2).

Offer B tendered $14 in Prior Lien Mortgage Six Per Cent Bonds and $6 in Adjustment Bonds and one share of common stock upon payment of $18 for each $100 of claim (Certificate, p. 3).

It will be noted that Offer A gives the unsecured creditor a preference as to one-third of his claim, but not as to two-thirds of it, and that Offer B is precisely the same as the offer made to holders of preferred stock, except that the amount the creditor is required to pay for his bonds is $2 less for each $100 of claim.

Kansas City Terminal Railway Company *et al.*, appellants below, contended in the District Court and also in the Circuit Court of Appeals that neither Offer

A nor Offer B "preserved" the creditor's "interest" and therefore, that neither was "a fair offer" within the Boyd case (228 U. S. l. c. 508). The Circuit Court of Appeals, by its certificate, in effect, requests that this court make more specific the application of its decision in the Boyd case.

After the certificate was filed in this Court, the appellants below filed a motion in this Court to send up the entire record under Rule 37 of the Rules of this Court of December 22, 1911 (now Rule 34). This motion has not been determined by the Court and is still pending. The reasons for the motion are fully set out in the brief attached to the motion, and we deem it inappropriate to discuss them here, as this brief, under the rules of this Court, must be confined to the propositions of law certified.

SUMMARY OF THE ARGUMENT.

The ultimate question to be decided (upon which the answers to the questions propounded by the Circuit Court of Appeals depend) is whether the general creditor is entitled to retain in the new corporation his priority over the old stockholder, or whether he must be content with what the chancellor may find to be "fair" treatment; whether his rights and status are to be determined according to a definite principle, or according to the personal conceptions of individual judges.

The Boyd case recognizes the practical necessity of permitting stockholders to participate in a railroad re-organization, provided the unsecured creditors are also permitted to participate, and provided the priority of creditors over stockholders is not impaired. The Court says that the creditor's interest "can be preserved by the issuance on equitable terms of income bonds or preferred stock" (l. c. 508).

While the Court does not say that the method suggested is the only method, it is implied that either the method suggested or some substantial equivalent is essential.

This Court, moreover, in the case of *Louisville Trust Company* v. *Louisville, etc. Railway Company*, 174 U. S. 674, which preceded the Boyd case, plainly indicated that, if any interest of the mortgagor is preserved after foreclosure, the "prior rights" of general creditors must necessarily be secured and preserved and "any arrangement of the parties by which the *sub-*

ordinate rights and interests of the stockholders are attempted to be secured at the expense of the *prior rights* of either class of creditors comes within judicial denunciation" (l. c. 683).

The suggestion of the Court in the Boyd case that general creditors need not be paid in cash is really a relaxation of the general principle of equity that the property of a corporation in the hands of a voluntary transferee or of the mortgagor purchasing at its own sale is still subject to all claims existing against it before the transfer. This indulgence to the re-organizer grows out of the practical impossibility of selling railroad properties for cash, the public interest in their successful financing and operation and the practical need of securing co-operation, instead of conflict, between the bondholder and the stockholder. It is analogous to the judicial rules regarding preferential claims for operating expenses and the issuance of receiver's certificates to insure continued operation of railroads. Like them, it must not be extended beyond the reason for its existence nor be allowed to degenerate into a mere phrase to be applied according to the individual whim of the Chancellor. The Boyd case emphatically declared that the question whether *any* provision must be made for the creditor must be determined by a "fixed principle." Equally, the question *what* provision must be made for the creditor must be determined by a fixed principle. The only fixed principle which is consonant with the spirit of the Boyd case is suggested by the language of the Boyd case—the issuance of securities to the general creditor which will preserve the normal

relation between him and the stockholder of the old company. It is difficult, if not impossible, to formulate any other fixed principle which is not purely arbitrary.

This principle has the advantage of enabling reorganization managers to know what they can do and creditors to know what their rights are.

It is thoroughly practical. It was successfully applied as early as 1882 in the Toledo, Peoria and Warsaw reorganization (9 Fed. 738) and has aided two of the largest and most successful railroad reorganizations of recent years—the Missouri Pacific (280 Fed. 38) and the Rock Island (284 Fed. 945).

The only offers to creditors which have been upheld by any of the Circuit Courts of Appeals since the Boyd case upon direct attack are the offers in the Missouri Pacific case and the Rock Island case, both of which gave the creditor preferred stock to the full amount of his claim.

These conclusions require negative answers to the questions certified.

ARGUMENT.

Nature of the Questions.

In order to meet the questions propounded by the Circuit Court of Appeals, it is necessary to know what the Boyd case settled and what it left open.

All will agree that it settled the proposition that, if the stockholder participates in a railroad re-organization, *some* provision must be made for the general creditor.

Opposing counsel will contend that it left open the question *what* provision must be made for the creditor.

Our position is that the decision, when read in the light of its judicial history and of the reasons which prompted it, settled this question, too, for all practical purposes; that is to say, the logical conclusion to be drawn from the decision is that the general creditor must be offered some form of participation which will maintain the normal relation between creditor and stockholder and preserve to the creditor his priority in rank over the old stockholder.

Our argument will be better understood if preceded by a brief sketch of the decisions of this Court and of the lower Federal Courts both before and after the decision of the Boyd case.

The Boyd Case and Later Cases.

The Boyd case was decided on April 28, 1913. This Court held that an unsecured creditor of a railroad company could, in equity, subject to his claim the prop-

erty of a railroad company in the hands of a re-organized company which purchased at foreclosure sale, because the stockholders of the old company participated in the re-organization by exchanging their stock for stock in the re-organized company, and no provision was made, either by the plan of re-organization or in pursuance of it, for participation by the unsecured creditors. The basis of the stockholders' participation was (1) one-half share of new preferred stock and one-half share of new common stock for each share of old preferred stock—upon payment of $10 for each old share held, and (2) one share of new common stock for each share of old common stock, upon payment of $15 per share. No bonds or other preferred securities were received by the stockholders in return for these assessments.

By way of dictum, the Court said that, in a railroad reorganization, the general creditors need not be paid in cash, but that their interests could be "preserved by the issuance on equitable terms of income bonds or preferred stock."

The Court's theory is best stated in the Court's own language:

> * * * "The case, though presenting various aspects, is controlled by a single proposition. For although Boyd was not a party to the foreclosure, and was not made such by the publication notifying creditors to prove their claims, yet the original and supplemental decrees were *free from any moral or actual fraud* and were, in form and nature, sufficient to have passed a title good against him, unless the contract of reorganization, reserving a stock interest in the new company for the old share-

holders, left the property still subject to the claims of non-assenting creditors of the Northern Pacific Railroad (l. c. 501, 502).

"Corporations, insolvent or financially embarrassed, often find it necessary to scale their debts and readjust stock issues with an agreement to conduct the same business with the same property under a reorganization. This may be done in pursuance of a private contract between bondholders and stockholders. And though the corporate property is thereby transferred to a new company, having the same shareholders, the transaction would be binding between the parties. *But, of course, such a transfer by stockholders from themselves to themselves cannot defeat the claim of a non-assenting creditor.* As against him the sale is void in equity, regardless of the motive with which it was made. For if such contract re-organization was consummated in good faith and in ignorance of the existence of the creditor, yet when he appeared and established his debt the subordinate interest of the old stockholders would still be subject to his claim in the hands of the reorganized company. *Cf. San Francisco & N. P. R. R.* v. *Bee*, 48 California 398; *Grenell* v. *Detroit Gas Co.*, 112 Michigan 70. *There is no difference in principle if the contract of reorganization, instead of being effectuated by private sale, is consummated by a master's deed under a consent decree* (l. c. 502).

"It is argued that this is true only where there is fraud in the decree—the appellants insisting that in all other cases a judicial sale operates to pass a title which cuts off all claims of unsecured creditors against the property."

(Here follow citation and discussion of cases cited.)

* * * "This makes the creditor's legal right against the shareholders' interest depend upon the motive with which they act and the method by which they carry out the scheme. * * *

"Such and similar possibilities at one time caused doubts to be expressed as to whether a court could permit a foreclosure sale which left any interest to the stockholders. But it is now settled that such reorganizations are not necessarily illegal, and, as proceedings to subject the property must usually be in a court where those who ask equity must do equity, such reorganizations may even have an effect more extensive than those made without judicial sale, and bind creditors who do not accept fair terms offered. The enormous value of corporate property often makes it impossible for one, or a score, or a hundred bondholders to purchase, and equally so far for stockholders to protect their interests. A combination is necessary to secure a bidder and to prevent a sacrifice. Co-operation being essential, there is no reason why the stockholders should not unite with the bondholders to buy in the property" (l. c. 502, 503, 504).

"* * * For, if purposely or unintentionally a single creditor was not paid, or provided for in the reorganization, he could assert his superior rights against the subordinate interests of the old stockholders in the property transferred to the new company. *They were in the position of insolvent debtors who could not reserve an interest as against creditors.* Their original contribution to the capital stock was subject to the payment of debts. The property was a trust fund charged primarily with the payment of corporate liabilities. Any device, whether by private contract or judicial sale under consent decree, whereby stockholders were preferred before the creditor was invalid. *Being bound for the debts, the purchase of their property, by their new company, for their benefit, put the stockholders in the position of a mortgagor buying at his own sale* (l. c. 504, 505).

* * * "*As between the parties and the public generally, the sale was valid. As against creditors, it was a mere form.* Though the Northern Pacific Railroad was divested of the legal title, *the*

old stockholders were still owners of the same railroad, encumbered by the same debts. The circumlocution did not better their title against Boyd as a non-assisting creditor. They had changed the name but not the relation. The property in the hands of the former owners, under a new charter, was as much subject to any existing liability as that of a defendant who buys his own property at a tax sale (l. c. 506, 507).

"The invalidity of the sale flowed from the character of the reorganization agreement regardless of the value of the property, for in cases like this, *the question must be decided according to a fixed principle*, not leaving the rights of the creditors to depend upon the balancing of evidence as to whether, on the day of sale the property was insufficient to pay prior encumbrances (l. c. 507).

* * * "*This conclusion does not*, as claimed, require the impossible and *make it necessary to pay an unsecured creditor in cash* as a condition of stockholders retaining an interest in the reorganized company. *His interest can be preserved by the issuance, on equitable terms, of income bonds or preferred stock.* If he declines a fair offer he is left to protect himself as any other creditor of a judgment debtor, and, having refused to come into a just reorganization, could not thereafter be heard in a court of equity to attack it. If, however, no such tender was made and kept good he retains the right to subject the interest of the old stockholders in the property to the payment of his debt" (l. c. 508).

(Italics in this and subsequent quotations are ours.)

It will be noted that the Court treats a re-organized company in which the stockholders of the old company participate, and the creditors do not, as in precisely the situation of a new company organized by the same stockholders and receiving a voluntary transfer of the prop-

erty (l. c. 502) or a mortgagor buying at its own sale (l. c. 504) or an owner buying in its own property at a tax sale (l. c. 507).

The Boyd case has been followed by *The Kansas City Southern Railway Company* v. *Guardian Trust Company*, 240 U. S. 166, (decided February 21, 1916), and *Pierce* v. *United States*, 255 U. S. 398, (decided March 7, 1921).

In the Kansas City Southern case, the attention of this Court was chiefly occupied with questions affecting the right of the Guardian Trust Company to take advantage of the doctrine of the Boyd case. The doctrine itself was referred to as the "well settled rule of equity" (l. c. 178). The dissents in the case were based upon the finding of the master that there was no liability, to which the Guardian Trust Company had not excepted (See *Central Improvement Company* v. *Cambria Steel Company*, 210 Fed. l. c. 699).

In the Pierce case, this Court affirmed a decree which satisfied a judgment against the Waters-Pierce Oil Company out of the proceeds of the sale of the property of that company in the hands of its stockholders. The Court relied upon the Boyd case and the Kansas City Southern case and treated the situation of stockholders receiving the proceeds of the sale in cash as parallel to that of stockholders participating in a reorganization upon foreclosure. The Court said:

> "* * * The law which sends a corporation into the world with the capacity to act imposes upon its assets liability for its acts. The corporation cannot disable itself from responding by distribut-

ing its property among its stockholders and leaving remediless those having valid claims" (l. c. 402).

The decision in the Boyd case was forecast by the decisions of this Court in *Chicago, Rock Island & Pacific Railroad Company* v. *Howard,* 7 Wall. 392, (decided February 8, 1869) hereafter called the "Howard case," and *Louisville Trust Company* v. *Louisville, etc. Railroad Company,* 174 U. S. 674, (decided May 22, 1899), hereafter called the "Monon case."

The Howard Case.

In the Howard case, the bondholders and the stockholders, by agreement between themselves, arranged for a sale of the property of the Mississippi & Missouri Railroad Company to Chicago, Rock Island & Pacific Railroad Company and for the distribution of the proceeds of the sale among themselves in agreed proportions—the bondholders to receive 84 per cent of the purchase price and the stockholders, 16 per cent. It was agreed between them and the purchaser, that they would cause foreclosure of the mortgage, purchase at the sale by trustees, and transfer by the trustees to a new company to be organized by the purchaser. No provision was made for unsecured creditors. The Court affirmed a decree which subjected the stockholders' share of the proceeds of the sale to the claim of an unsecured creditor. The Court said:

"Equity regards the property of a corporation as held in trust for the payment of the debts of the corporation, and recognizes the right of creditors to pursue it into whosesoever possession it may

be transferred, unless it has passed into the hands of a bona fide purchaser; and the rule is well settled that stockholders are not entitled to any share of the capital stock nor to any dividend of the profits until all the debts of the corporation are paid.

* * * * * * *

"Valid contracts made by a corporation survive even its dissolution by voluntary surrender or sale of its corporate franchises, and the creditors of the corporation, notwithstanding such surrender or sale, may still enforce their claims against the property of the corporation as if no such surrender or sale had taken place. Moneys derived from the sale and transfer of the franchises and capital stock of an incorporated company are assets of the corporation, and as such constitute a fund for the payment of its debts, and if held by the corporation itself and so invested as to be subject to legal process, the fund may be levied on by such process; but, if the fund has been distributed among *the stockholders, or passed into the hands of other than bona fide creditors or purchasers, leaving any debts of the corporation unpaid, the established rule in equity is, that such holders take the fund charged with the trust in favor of creditors,* which a court of equity will enforce, and compel the application of the same to the satisfaction of their debts.

"Regarded as the trustee of the corporate fund, the corporation is bound to administer the same in good faith for the benefit of creditors and stockholders, and all others interested in its pecuniary affairs, and any one receiving any portion of the fund by voluntary transfer, or without consideration, may be compelled to account to those for whose use the fund is held. *Creditors are preferred to stockholders on account of the pecuniary trust in their favor, and because the latter as constituent members of the corporate body, are regarded as sustaining, in that aspect, the same relation to the former as that sustained by the corporation*" (l. c. 409).

Between the decision of the Howard case and the decision of the Monon case, this Court had occasion to consider some phases of railroad foreclosures and reorganizations, and they are thus referred to in *Canada Southern Railway Company* v. *Gebhard*, 109 U. S. 527:

> "It rarely happens in the United States that foreclosures of railway mortgages are anything else than the machinery by which arrangements between the creditors and other parties in interest are carried into effect, and a reorganization of the affairs of the corporation under a new name brought about" (l. c. 539).

The Monon Case.

In the Monon case, the Court held that an unsecured creditor, on intervention, had a right to be heard upon his allegations that a railroad foreclosure and re-organization had been instituted and were being conducted for the purpose of preventing the collection of any unsecured debts and of keeping in the stockholders an interest in the new company to the exclusion of the creditors, and reversed a decree of the lower court which had dismissed the intervention without hearing evidence. This Court said:

> "We refer to these matters not for the sake of reviewing those decisions, but to note the fact that foreclosure proceedings of mortgages covering extensive railroad properties are not necessarily conducted with the limitations that attend the foreclosures of ordinary real estate mortgages.
>
> "We notice, again, that railroad mortgages, or trust deeds are ordinarily so large in amount that on foreclosure thereof only the mortgagees, or their representatives, can be considered as probable purchasers. While exceptional cases may occur, yet

this is the rule, as shown by the actual facts of foreclosure proceedings, as well as one which might be expected from the value of the property and the amount of the mortgage (l. c. 682).

* * * * * * *

"Assuming that foreclosure proceedings may be carried on to some extent at least in the interests and for the benefit of both mortgagee and mortgagor, (that is, bondholder and stockholder), we observe that no such proceedings can be rightfully carried to consummation which recognize and preserve any interest in the stockholders without also recognizing and preserving the interests, not merely of the mortgagee, but of every creditor of the corporation. In other words, if the bondholder wishes to foreclose and exclude inferior lienholders or general unsecured creditors and stockholders he may do so, but *a foreclosure which attempts to preserve any interest or right of the mortgagor in the property after the sale must necessarily secure and preserve the prior rights of general creditors thereof.* This is based upon the familiar rule that the stockholder's interest in the property is subordinate to the rights of creditors; first of secured and then of unsecured creditors. And any arrangement of the parties by which the subordinate rights and interests of the stockholders are attempted to be secured at the expense of the prior rights of either class of creditors comes within judicial denunciation" (l. c. 683, 684).

"* * * Can it be that when in a court of law the right of an unsecured creditor is judicially determined, and that judicial determination carries with it a right superior to that of the mortgagor, the mortgagor and mortgagee can enter into an agreement by which through the form of equitable proceedings all the right of this unsecured creditor may be wiped out, and the interest of both mortgagor and mortgagee in the property preserved and continued? The question carries its own answer. Nothing of the kind can be tolerated" (l. c. 684).

"We may observe that a court, assuming in foreclosure proceedings the charge of railroad property by a receiver, can never rightfully become the mere silent registrar of the agreements of mortgagee and mortgagor" (l. c. 688).

Decisions in the lower federal courts after the Howard case and the Monon case.

Following the decision of this Court in the Howard case, there was comparatively little consideration of its effect in the decisions of the Federal Courts. Apparently, both counsel and the courts overlooked its prophetic character. Doubtless, a number of re-organizations were consummated, which today would be open to attack under the Boyd case.

The few cases which do discuss the Howard case show no unanimity in their conception of it.

The earliest case which we have found is *Hancock* v. *Toledo, etc., Railroad Company,* 11 Biss. 148, 9 Fed. 738, decided by Blodgett, J., in the Northern District of Illinois on January 4, 1882. It was there sought to subject to the claim of an unsecured creditor the common stock of a new company purchasing at a foreclosure sale under a re-organization plan. The framers of the re-organization plan evidently had a thorough comprehension of the potential effect of the Howard case, because the plan is one which would be sustained today as against unsecured creditors under the Boyd case. The re-organization plan called for a first mortgage and a second mortgage—the latter securing both first preferred income bonds and second preferred income bonds. The unsecured creditors of the old company were to receive second preferred income bonds to the entire amount of their indebtedness *and interest.*

The holders of the first preferred stock of the old company were to receive common stock of the new company to the amount of 50 per cent of their former holdings. The holders of old second preferred stock were to receive new common stock to the amount of 30 per cent of their former holdings, and the holders of old common stock were to receive new common stock to the amount of 25 per cent of their former holdings—the stock of the new company being all common stock. The court held that sufficient provision was made for the creditors within the rule of the Howard case, saying:

> "It will be seen that while the Mississippi & Missouri Railroad Company was largely indebted to certain unsecured creditors, no provision was made under the scheme of re-organization for any payment or security to the unsecured creditors. * * *
>
> "Here, however, express provision is made for the holders of all the floating debt by giving them, in lieu of and substitution for their evidences of debt against the old company, second preferred income bonds of the new company equal to the amount of such floating debt and interest. This income bond is, by the terms of agreement, a higher grade of security than the stock of the old company; that is, the stockholders get no dividend until the interest on these bonds is all paid. The stockholders are placed behind the holders of these bonds, and the plan seems to fairly contemplate the protection of all classes of creditors of the old company *in the equitable order of their priority.* It was the evident purpose of the parties to this agreement to *place these floating-debt holders in at least as good a relation to the new company as they bore to the old company*" (l. c. 741, 742).

On the other hand, in *Paton* v. *Northern Pacific Railway Company*, 85 Fed. 838 (decided July 22, 1896),

a distinguished jurist, Judge Jenkins, held sufficient as to unsecured creditors the very re-organization plan condemned in the Boyd case. He held that it must be determined from the facts of each particular case whether the unsecured creditor could complain of being eliminated, saying:

> "It is no doubt true, as ruled in *Railroad Co.* v. *Howard*, 7 Wall. 392, that the disposition of the property of a corporation among its stockholders without providing for the payment of the debts of the corporation is a fraud upon creditors. It, however, is essential to look at the facts of each case in order to accurately apply the principle enunciated; for if the contention of counsel for complainant be correct, all agreements of re-organization of bankrupt corporations which fail to give all creditors of the corporation an interest in the re-organization, or which fail to satisfy the debts of the corporation, and which accord to stockholders of the old corporation upon any terms an interest in the new corporation, are prohibited by the law, and void. If such conclusion result from the decision in the Howard Case, the result must prove disastrous, uprooting past re-organizations of great magnitude, and seriously crippling, if not preventing, any future re-organization of bankrupt corporations" (l. c. 840).

In *Central of Georgia Railway Company* v. *Paul*, 93 Fed. 878, (C. C. A. 5th Circuit, decided April 18, 1899), the court affirmed a decree enforcing the claim of an unsecured creditor, for whom no provision had been made in a re-organization plan. The plan gave the minority stockholders of the old company income bonds for the full amount of their stock (l. c. 882) and the majority stockholders $5,000,000 par value of stock in the new company for $4,200,000 par value of stock in the

old company (l. c. 882). The court relied on the Howard case.

See also *Farmers' Loan & Trust Company* v. *Missouri I. & N. Railway Company*, 21 Fed. 264, 267 (Circuit Court, S. D. Iowa, 1884).

Chattanooga R. & C. Railroad Company v. *Evans*, 66 Fed. 809, 822 (C. C. A. 6th Circuit, 1895).

Even the decision in the Monon case apparently did not prepare all of the bar nor all of the lower Federal Courts for the decision in the Boyd case. In fact, some of the language in the Monon case lent color to the view that actual fraud was a necessary element, and this theory was, in some instances, eagerly applied without any real effort to analyze the underlying principles governing the Howard case and the Monon case.

In the first reported opinion considering the Monon case, however, a clear conception of the case is exhibited (*St. Louis Trust Company* v. *Des Moines, etc., Railway Company*, 101 Fed. 632, decided May 18, 1900). Judge Shiras of the Southern District of Iowa, there held that the assets purchased at foreclosure sale by a re-organized company should be subjected to the claim of an unsecured creditor of the old company, where no offer had been made to the unsecured creditors and where the stockholders of the old company exchanged their stock for stock in the new company.

At about the same time, Circuit Judge Woods, who had been in charge of the receivership and foreclosure involved in the Monon case, and to whose lot fell the

creditor was excluded and the stockholder included. It made it equally clear that the creditor's rights must be determined according to a fixed principle (l. c. 507) and not upon some hazy determination by the chancellor as to whether the creditor had been "unfairly eliminated" or there was "actual fraud."

Since, however, no offer at all had been made to the creditor in the Boyd case, it was not necessary for the Court to define in precise terms what was requisite for a sufficient offer. Consequently, we find the same tendency on the part of re-organization managers and some of the Federal Courts to whittle away the creditors' rights, which occurred following the decisions in the Howard case and the Monon case. On the other hand, we find some re-organization plans and some of the decisions of the Federal Courts (including all of the decisions of the Circuit Courts of Appeals, so far as they directly involve the question) giving full recognition to the spirit and evident intent of this Court's decision in the Boyd case. Pertinent decisions in the state courts are rare.

(a) Decisions in the Circuit Courts of Appeals.

Keech v. *Stowe-Fuller Company,* 205 Fed. 887, (C. C. A. 6th Circuit, decided June 3, 1913). The re-organization plan provided that holders of both preferred and common stock should have the right to subscribe for bonds to the amount of ten per cent of their holdings and to receive in exchange for their stock—the holders of preferred stock, 100 per cent in common stock of the new company, and the holders of common stock, 50 per

cent in common stock of the new company. The creditors were give 50 per cent in cash. *The court did not pass upon the re-organization plan, as its fairness was not before the court.* The only question before the court was whether a particular intervener was entitled to the benefit of the plan, and the court held that it was. The corporation re-organized was not a railroad company.

Western Union Company v. *United States & Mexican Trust Company,* 221 Fed. 545, (C. C. A. 8th Circuit, decided March 16, 1915). The Company involved was the Kansas City, Mexico and Orient Railway Company. The re-organization plan apparently made no provision for creditors. The exact nature of the provision made for stockholders does not appear in the opinion. The court did not pass on the fairness of the plan, but held that the lower court committed error in refusing to permit an intervening creditor to raise the question of its fairness by his intervention. The discussion of principles went only so far as was necessary to decide the point before the court. The language of the court was not intended to be and ought not to be construed as an accurate statement of the limits of those principles.

Howard v. *Maxwell Motor Company,* 269 Fed. 292, affirmed 275 Fed. 53 (C. C. A. 2nd Circuit, decided June 1, 1921). A re-organization plan provided that the creditors of subsidiary companies should be paid in full in cash, that the creditors of the parent company should receive for each $100 of indebtedness:

Cash,	$25.00
First Preferred Stock in New Company,	25.00
Second Preferred Stock,	25.00
Common Stock,	15.00
	$90.00

And that the holders of preferred stock of the parent company should receive upon payment of $24 for each share of stock in the old company:

New First Preferred Stock,	$24.00
New Second Preferred Stock,	25.00
New Common Stock,	30.00
	$79.00
Less "Assessment,"	24.00
	$55.00

And that the holders of common stock of the parent company should receive upon payment of $24 per share of stock:

First preferred Stock,	$24.00
Second Preferred Stock,	17.50
Common Stock,	30.00
	$71.50
Less "Assessment,"	24.00
	$47.50

Here again, *the fairness of the plan was not considered*, but it was held that the holder of a contingent claim, for whom no provision was made in the plan, was entitled to enforce his claim against the assets of the

old company in the hands of the new company. The corporation re-organized was not a railroad company.

Walsh Tie & Timber Company v. *Missouri Pacific Railway Company*, 280 Fed. 38 (C. C. A. Eighth Circuit, decided March 29, 1922). The fairness of the offer to creditors was directly involved. By the plan, holders of stock in the old company were to receive stock in the new company par for par, upon paying $50 a share, for which they were to receive at par General Mortgage Four Per Cent Bonds of the new company (l. c. 43). Creditors were tendered five per cent preferred stock at par for the full amount of their claims. The court said regarding the creditors' contention: "Their complaint is that they were not paid in full, instead of being offered preferred stock" (l. c. 44). The Court held the offer to be sufficient under the Boyd case, saying:

> "They further lose sight of the fact that the offer made to them in the plan preferred them over common stockholders, and that their relative rights as against the stockholders in the old companies were not changed by the plan, except as to 450 shares of the Iron Mountain, which was too small to seriously affect their interests as proposed by the plan" (l. c. 44).

Phipps v. *Chicago, Rock Island & Pacific Railway Company*, 284 Fed. 945 (C. C. A. Eighth Circuit, decided October 9, 1922; certiorari granted, 261 U. S. 611; dismissed per stipulation, 262 U. S. 762). Phipps had secured a judgment against the Chicago, Rock Island & Pacific Railway Company in a state court, and the suit was for an injunction to prevent his enforcing his judgment by execution against the assets of the company.

Following the judgment in the state court, the District Court in Illinois had, without a foreclosure decree, approved a re-organization plan and attempted to bar all claims against the company. The plan tendered the unsecured creditor interest on his claim at the rate of five per cent up to June 30, 1917 (shortly after the date of the decree, l. c. 946) and six per cent preferred stock at par for the full amount of his claim, to be delivered on July 1, 1917 (l. c. 947). The stockholders were tendered, upon payment of an assessment of $40 a share, seven per cent preferred stock, par for par, in exchange for their old stock, which preferred stock, however, was inferior to the six per cent preferred stock given to the creditors (l. c. 946). The Circuit Court of Appeals held that the District Court had the right to enter the decree without foreclosure and that the claimant was barred by the terms of the decree and could not insist on payment in cash. The fairness of the offer as such was thus perhaps not directly involved. The court, however, undoubtedly considered the offer, because the court says on page 954 that the decree was "fair, equitable and just." Whether the decision is sound in approving the result reached without a foreclosure and in approving the exclusion of the creditor from enforcing his claim against the unmortgaged assets, need not be here discussed.

Mountain States Power Company v. *A. L. Jordan Lumber Company*, 293 Fed. 502 (C. C. A. 9th Circuit, decided October 29, 1923). By a re-organization plan, 23,400 shares of no par value stock were set aside for the satisfaction of unsecured claims. Provision was

made that this stock should first be offered to stockholders at $15 a share. At the time of the sale, however, only 1,532 shares of the entire 23,400 had been sold or taken up by stockholders.

The plan made extensive provision for bondholders, but the opinion does not state what provision was made for stockholders outside of the right to purchase at $15 a share the stock set aside for creditors. It appears, however, that one interest owned about 40 per cent of both bonds and stock (see 286 Fed. l. c. 218) and perhaps it was considered by the court that the stockholders' interest was preserved through the provision made for their bonds. At any rate, the court held that the plan was invalid as against an unsecured creditor, saying:

> "There was here no offer or tender of income bonds or preferred stock, as suggested in the Northern Pacific Case. Of course, the method there suggested is not exclusive, but in our opinion it is exclusive of such a provision as was here made" (l. c. 506).

The corporation involved was not a railroad company, but *was* a public utility company.

(b) Decisions in the District Courts.

So far as we know, there are only two reported cases in the District Courts (treating as one case two reported opinions and one unreported opinion by the same judge growing out of the same re-organization) in which an offer to creditors in connection with a reorganization plan is expressly tested by the doctrine of the Boyd case.

The first is *St. Louis-San Francisco Railway Company* v. *McElvain*, 253 Fed. 123, decided by Circuit Judge Sanborn of the Eighth Circuit. The McElvain case treated as *res judicata* a decree confirming the sale in the St. Louis-San Francisco Railway Company foreclosure case—out of which the McElvain case likewise arose—adjudging sufficient an offer to creditors. An unreported opinion which accompanied this decree and which was relied upon by opposing counsel in the courts below appears at page 495 of the record of this case in the Circuit Court of Appeals and will doubtless be referred to by opposing counsel in their briefs. In this opinion Judge Sanborn made the controlling factors his own judgment as to the value of the property at the time of sale, the improbability of the general creditors receiving anything on a strict foreclosure and the particular facts and circumstances of the case (the creditors were tendered in pursuance of the re-organization plan, 50% of their claims in preferred stock and 50% in common stock).

He said:

> "That is an estimate, but the Court is clearly of the opinion that if the lien holders who foreclosed their mortgage upon this property had proceeded to a sale of the property under their rights, no one could have been found who would have paid enough to satisfy the bonded liens, and there would have been nothing left for either creditors or stockholders. It was, in the opinion of the Court, only by virtue of this reorganization scheme, whereby the stockholders would take hold and assist to reorgan-

ize the company, and to take these new securities, or a portion of them, that anything whatever could have been saved for the common creditors. They never could have bought this property, they never could have reorganized this company, they never could have purchased this property so as to give to themselves anything above the amount required to pay the bonded debt. So that this estimate of three hundred twenty-one millions and this equity of ninety or ninety-one millions, when it comes to an actual foreclosure of the mortgage and the handling of a big property like this, is more imaginary than real. * * * Now, inasmuch as the Court is of the opinion and thinks that there is no doubt that these creditors would have received nothing whatever out of the foreclosure of this property, unless the Reorganization Committee had evolved a scheme or plan whereby this property could be distributed among stockholders and creditors, and would have lost everything, and, *inasmuch as under this offer each creditor is given a larger percentage of his claim in actual value than any stockholder received, the offer cannot be said to be unfair or untimely.* It is an advantage to the creditor to have such a plan or scheme, an advantage from which they derive about 25 per cent of their claims, where, if there had been no such plan or scheme, they would have received nothing."

The McElvain case was followed by Judge Sanborn in *North American Company* v. *St. Louis & San-Francisco Railroad Company*, 288 Fed. 612, 626.

It is thus apparent that Judge Sanborn saw no necessity of preserving the priority of the creditors. He felt that an offer to creditors was sufficient if the

creditor got a little bit more than the stockholder—how much more he would have to get and how the "actual value" should be measured, do not appear.

The argument made by Judge Sanborn is not far from the view expressed by Judge Jenkins in the Paton case, which was expressly disapproved by this Court in the Boyd case. His argument is also quite similar to that of Mr. Francis Lynde Stetson, Counsel for the Railway Company in the Boyd case (l. c. 494). It appears to be opposed to the statement of this Court in the Boyd case that "the invalidity of the sale flowed from the character of the reorganization agreement *regardless of the value of the property,* for, in cases like this, the *question must be decided according to a fixed principle,* not leaving the rights of the creditors to depend upon the balancing of evidence as to whether, on the day of sale the property was insufficient to pay prior encumbrances" (l. c. 507).

The other case was decided by Judge Sanborn's colleague on the Circuit Court of Appeals for the Eighth Circuit—Judge William C. Hook, since deceased (*Guaranty Trust Company* v. *Missouri Pacific Railway Company,* 238 Fed. 812, decided November 28, 1916). This case involved the Missouri Pacific reorganization plan, which was also considered in *Walsh Tie & Timber Company* v. *Missouri Pacific Railway Company, supra,* but the appeal in the Walsh case was taken from a subsequent order, not from the order considered in the Guaranty Trust Company case. In that plan, as will be remembered, the general creditor was given preferred

stock for the entire amount of his claim, whereas the stockholder was entitled to exchange his stock for new common stock on condition that he subscribe and pay for 4% Prior Lien Bonds to the amount of 50% of his stock holdings. The objection to the plan in the Guaranty Trust Company case was by the holders of the bonds of a subsidiary which had been guaranteed by the parent company. The reorganization plan treated these bondholders as general creditors. The court held, first, that, if these bond holders were to be considered as general creditors, the offer was fair, but second, that, on account of their lien on the property of the subsidiary, they were entitled to more than general creditors. The court said with reference to the offer to the general creditors:

> "*The normal relation between the two, general creditor and stockholder, is preserved.* The common stockholder is always last in the scale. Here the general creditor is just before him, and his priority is preserved by preferred stock of the New Company" (l. c. 818).

The fact that Circuit Judges and District Judges have not been unanimous in applying the Boyd case according to its logical conclusion is no argument against that conclusion. There was an even greater lack of unanimity among the judges in the period following the decision of the Howard case, and the decision of the

Monon case.*

(c) Decisions in state courts.

In *Wabash Railway Company* v. *Marshall,* 224 Mich. 593, 600, the Supreme Court of Michigan, relying expressly on the Boyd Case, held that an offer

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*The Boyd case has been cited, but without analytical discussion of the points here involved, in the following cases, (Citations involving only the doctrine of laches not included): *West* v. *Edward Rutledge Timber Company,* 244 U. S. 90, l. c. 96 (1917); *Hamer et al.* v. *New York Rys. Co. et al.,* 244 U. S. 266, l. c. 270; (1917); *Waller et al. Trustees* v. *Texas & Pacific Ry. Co.,* 245 U. S. 398, l. c. 410 (1918); *Southern Pacific Co.* v. *Bogert,* 250 U. S. 483, l. c. 493 (1919); *Ewart* v. *Blue Jacket,* 259 U. S. 129, l. c. 138 (1922); *Mechanics & Metals National Bank* v. *Howell,* 207 Fed. 973, l. c. 980, 983 (1913); *Central Electric Co.* v. *Socorro Electric Co., et al.,* 209 Fed. 534, l. c. 541, (C. C. A. 8th Circuit, 1913); *West* v. *Edward Rutledge Timber Co.,* 210 Fed. 189, l. c. 194, (D. C. Idaho, 1913); *Investment Registry* v. *Chicago & M. E. R. Co.,* 212 Fed. 594, l. c. 610, (C. C. A., 7th Circuit, 1923); *In Re Howell,* 215 Fed. 1, l. c. 7 (C. C. A., 2nd Circuit, 1914); *Equitable Trust Co.* v. *United Box Board & Paper Co.,* 220 Fed. 714, l. c. 719, (D. C. N. J., 1925); *Davis* v. *Virginia Ry. & Power Co.,* 229 Fed. 633, l. c. 641, l. c. 643, (C. C. A. 4th Circuit, 1915); *Vallery* v. *Denver & Rio Grande R. Co.,* 236 Fed. 176, l. c. 181, (C. C. A., 8th Circuit, 1916); *Blue Ridge Electric Co.* v. *American Bank Note Co.,* 237 Fed. 755, l. c. 762; (C. C. A., 5th Circuit, 1916); *Equitable Trust Co. of New York* v. *Western Pac. Ry. Co.,* 244 Fed. 485, l. c. 505 (D. C. New York, 1917); *Okmulgee Window Glass Co.* v. *Frink,* 260 Fed. 159; l. c. 162, 167, 168, (C. C. A., 8th Circuit, 1918); *National Circle, Daughters of Isabella* v. *National Order of Daughters of Isabella,* 270 Fed. 723, l. c. 732, (C. C. A. 2nd Circuit, 1920); *Oehring* v. *Fox Typewriter Co.,* 272 Fed. 833, l. c. 835, (C. C. A.,

to general creditors made under the Wabash re-organization plan, which tendered to creditors 25 per cent of their claims in preferred stock and 75 per cent in common stock, was not sufficient to bar the claim of a non-assenting creditor to be paid in cash.

6th Circuit, 1921); *Plews* v. *Burrage,* 274 Fed. 881, l. c. 888 (C. C. A., 1st Circuit, 1921); *Ozan Lumber Co. et al.* v. *Davis Sewing Machine Co., et al.,* 284 Fed. 161, l. c. 165, (D. C. Delaware, 1922); *Bogert et al.* v. *Southern Pacific Co.,* 285 Fed. 46, l. c. 47 (D. C. New York, 1922); *Taylor* v. *Salt Creek Consolidated Oil Co.,* 285 Fed. 532, l. c. 537, (C. C. A. 8th Circuit, 1922); *Mountain States Power Co.* v. *Jordan Lbr. Co.,* 286 Fed. 217, l. c. 221, (D. C., Montana, 1923); *Cashman et al* v. *Hitchcock,* 293 Fed. 958, l. c. 961 (C. C. A., 1st Circuit, 1923); *Safety Car Heating & Lighting Co.* v. *United States Light & Heating Co.,* 2 F. (2d), 384, l. c. 386, 388 (D. C. New York, 1924); *Flemming* v. *Taylor Fuel, Light & Power Co.,* 90 Kan. 763, l. c. 774; (1913); *Jennings, Neff & Company* v. *Crystal Ice Co.,* 128 Tenn. 231, l. c. 242; (1913); *Zwietusch et al* v. *Luehring et al.,* 156 Wis. 96, l. c. 117; (1914); *Pittsmont Copper Co.* v. *O'Rourke.* 49 Mont. 281, l. c. 293, 303; (1914); *Smythe* v. *Central Vermont Ry. Co.,* 88 Vt. 59, l. c. 69; (1914); *Clark* v. *Bankers' Trust Co.,* 163 N. Y. S. 748, l. c. 755, (1917); *Clark* v. *Bankers' Trust Co.,* 177 N. Y. App. Div., l. c. 634, 164 N. Y. S. 544, l. c. 549, (1917); *Male* v. *Atchison, Topeka & S. F. R. Co.,* 197 N. Y. App. Div. 88, l. c. 89, 91, 94, 105; 166 N. Y. S. 593, l. c. 594, 596, 597, 605, (1917); *Sweeney* v. *O'Brien Mining Co.,* 194 Mo. App. 140, l. c. 149, l. c. 150, l. c. 151, (1916); *Burnwell Coal Co.* v. *Setzer,* 203 Ala. 395, l. c. 397; (1919); *Male* v. *Atchison, Topeka & Santa Fe Ry. Co.,* 230 N. Y., 158, l. c. 166; (1920); *Johnson* v. *United Rys. Co. et al,* 281 Mo. 90, l. c. 163; (1920); *Ballew Lumber Co.* v. *Missouri Pacific Railway Co.,* 288 Mo. 473, l. c. 478; *Hughes* v. *City Trust Co.,* 151 La. 313, l. c. 328.

The rights of railroad creditors ought to be determined by a definite principle of equity modifying as little as possible ordinary principles of equity, and not by the unguided opinion of the chancellor as to what constitutes a sufficient offer.

Equity is a system of jurisprudence, not a set of ideals to be applied according to the moral conceptions of the judges who happen to be in office.

> "The court, therefore, will entertain jurisdiction of the cause, but will exercise that jurisdiction in conformity with the settled principles of a court of chancery" (Mr. Chief Justice Marshall, in *Bodley* v. *Taylor*, 5 Cranch 191, l. c. 223).
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> "The hardships of a particular case would not justify this tribunal in prostrating the fundamental rules of a court of chancery" (Mr. Chief Justice Marshall in *Crocket* v. *Lee*, 7 Wheat, 522, l. c. 527).
>
> "The rules of equity are as fixed as those of law, and this court can no more depart from the former than the latter" (Mr. Justice Swayne in *Wright* v. *Ellison*, 1 Wall. 16, l. c. 22).

See also *Fontain* v. *Ravenel*, 17 How. 369, 395; *Rees* v. *Watertown*, 19 Wall. 107, 122.

> "The cases which occur are various; but they are decided on fixed principles. Courts of equity have, in this respect, no more discretionary power than courts of law. * * *
>
> "But the principles are as fixed and certain as the principles on which the courts of common law proceeded" (Lord Redesdale in *Bond* v. *Hopkins* 1 Sch. & Lefr. 428, quoted in Story, Equity, 14th Ed. Sec. 20).
>
> "In short, if a court of equity in England did really act as many ingenious writers have supposed it (from theory) to do, it would rise above all law, either common or statute, and be a most arbitrary legislator in every particular case" (Story, Equity,

Sec. 19, quoting from Blackstone's Commentaries).

> "Nor would a chancellor at the present day assume to decide the facts of a controversy according to his own standard of right and justice, independently of fixed rules—he would not attempt to exercise the *arbitrium boni viri*" (Pomeroy, Equity Jurisdiction, 3rd Ed., Sec. 47).

The decision in the Boyd case was but an application of the principles of equity laid down in the Howard case and the Monon case, and later enforced in the Pierce case. The Court, however, recognized the practical necessity of permitting stockholders to participate in railroad reorganizations, and, by a *dictum*, clearly indicated that these principles of equity would have to be modified to meet the practical necessities of the situation and the public interests involved. The Court thus relaxed principles, equitable enough in ordinary cases, but inequitable in railroad foreclosures, if literally applied.

The principles were not destroyed, however. They were merely modified by the establishment of a new principle of equity. This new principle does not delegate an unbounded discretion to the chancellor, any more than did the old ones. It establishes a new but definite standard of measurement.

The Court had previously modified ordinary equitable principles for similar reasons; once, in the matter of preferred claims for operating expenses (*Fosdick* v. *Schall*, 99 U. S. 235), and, again, in the matter of receivers' certificates issued for the continued operation of railroads (*Union Trust Company* v. *Illinois Midland Railway Company*, 117 U. S. 434).

In each case, the relaxation of the rule went only so far as the necessity, and this Court has had occasion to restrict sharply the growing tendency to determine such matters without fixed principle, but according to the personal discretion of the chancellor (*Wood* v. *Guaranty Trust Company*, 128 U. S. 416, *Kneeland* v. *American Loan and Trust Company*, 136 U. S. 89; *Gregg* v. *Metropolitan Trust Company*, 197 U. S. 183. See also *Hanna* v. *State Trust Company*, 70 Fed. 2, C. C. A. 8th Circuit, and *Smith* v. *Shenandoah Bank*, 246 Fed. 379, C. C. A. 4th Circuit).

The doctrines just referred to apply only to railroads (or possibly in some respects to other public utilities); and the relaxation of the ordinary principles of equity effected by the dictum in the Boyd case is likewise so limited.

What the Court says in the Boyd case about determining the validity of the sale (and hence, whether *any* provision must be made for creditors) is in precise accord with what we have said and applies with equal force to determining *what* provision must be made for creditors. "The question must be decided *according to a fixed principle*, not leaving the rights of the creditors to depend upon the balancing of evidence," (l. c. 507). And that fixed principle must be determined with the same careful regard for the reason for relaxing the ordinary rule and with the same rigid limitation to the necessities of the case and of the public interest exemplified in the decisions of this Court dealing with preferred claims and receivers' certificates.

The necessity here arises from the desire of the bondholders to secure the co-operation of the stockholders, rather than their opposition, and from the usefulness of additional cash in putting the new corporation on its feet. As the court says in the Boyd case: "A combination is necessary to secure a bidder and prevent a sacrifice. Co-operation being essential, there is no reason why the stockholders should not unite with the bondholders to buy in the property" (l. c. 504). The same idea is expressed in different language by a distinguished and experienced lawyer in a monograph on re-organizations, Mr. Paul D. Cravath:

> "But still in most large re-organizations, the stockholders knock loudly at the door for participation, and it is still the preference of most bondholders' committees to afford them participation, partly to avoid the dissatisfaction, litigation and delay which might result from their exclusion, and partly to secure new capital by appealing to the desire of stockholders to retain their interest in the property and their consequent willingness to furnish new capital on more favorable terms than could be obtained from strangers" (Some Legal Phases of Corporate Financing, Re-organization and Regulation, by Francis Lynde Stetson, Paul D. Cravath and others, The MacMillan Company, 1922, page 195).

The stockholder, of course, ought to have a speculative chance of making something by his participation, and the creditor, under the liberal rule of the Boyd case, may be asked to *defer* his rights to give the stockholder that chance. But he cannot be asked to sacrifice them or to enter into a speculation with the stockholder. He must be assured that, if he waits long enough, he will

get his principal in full, either through the prosperity or the liquidation of the corporation, before the stockholder gets anything—and that, while he is waiting, he will get a return on his principal before the stockholder gets any income. Of course, if the re-organized company fails, he may get nothing or very little. But he must get that little before the stockholder gets anything. He must necessarily take a chance on the success of the re-organization, but he has a right to know that he is ahead of the stockholder. He cannot be compelled to run a race with the stockholder to see whose securities will have the highest quotations on the New York Stock Exchange. Equitable rights cannot be made to depend on any such widely fluctuating standard.

There is nothing in the language of the Boyd case which lends any color to the theory that the creditor must be satisfied if he gets slightly more securities than the stockholder, but without priority. On the contrary, the plain implication is that he is entitled to retain his rank, but that he cannot require cash, if his rank is preserved to him in securities. The Court says: "His interest may be *preserved*," and the language which immediately follows indicates that it is the creditor's *priority* which is to be preserved, rather than the empty shell of his claim—"by the issuance on equitable terms of income bonds or preferred stock" (l. c. 508).

The same idea is clearly implied in the Monon case:

> "We observe that no such proceedings" [foreclosures] "can be rightfully carried to consummation which recognize and preserve *any* interest in the stockholders without also recognizing and *preserving* the interests not merely of the mortgagee,

but of every creditor of the corporation. In other words, if the bondholder wishes to foreclose and exclude inferior lien holders or general unsecured creditors and stockholders, he may do so, but a foreclosure which attempts to preserve any interest or right of the mortgagor in the property after the sale must necessarily secure and *preserve* the *prior* rights of the general creditors thereof" (174 U. S. l. c. 683, 684).

Thus, "The *normal relation between the two,* general creditor and stockholder, *is preserved.* The common stockholder is always last in the scale. Here the general creditor is just before him, and *his priority* is preserved by preferred stock of the New Company" (*Guaranty Trust Company* v. *Missouri Pacific Railway Company,* 238 Fed. l. c. 818).

That there is no paramount necessity to relax the general rule of equity so far as to depart from all fixed principles and leave the whole question to the unregulated discretion of the Chancellor, is demonstrated by the fact that the two largest railroad re-organizations of recent times have been carried through in literal compliance with the fixed principle which we support—the Missouri Pacific and the Rock Island (280 Fed. 38, 44; 284 Fed. 945, 948)— and that these two companies are today highly successful and prosperous and among our largest systems.

Any rule, which, instead of preserving the creditor's rank over the stockholder, makes him take the same or similar grade of securities as the stockholder in equal or slightly greater amounts, compels the creditor to make a sacrifice. It means that a court of equity, instead of requiring him to *defer* his claim, compels him

to share his claim with his own debtor. The vagaries of the stock market might even produce a situation by which the stockholder, either through good luck or superior familiarity with the fluctuations of the market, would actually realize more than the creditor.

A court of equity has no "unlimited discretion" to destroy or reduce the creditor's claim, any more than it has to displace vested liens (see *Kneeland* v. *American Loan and Trust Company,* 136 U. S. l. c. 99). It cannot take the creditor's property and hand it over to the stockholder. It may require the creditor to wait (or lose, if the enterprise fails), but the stockholder must always have to wait longer (or lose first).

Mr. Justice Brewer in *Merchants Loan & Trust Company* v. *Chicago Railways Company,* 158 Fed. 923 (C. C. A. 7th Circuit) held that a court of equity administering a receivership could not subordinate a mortgage lien to a new mortgage to be executed by a new company to be formed under a re-organization plan—even though all parties were before the court—however great the advantage to the property and to the supposed interests of the parties. Mr. Justice Brewer said:

> "Now, that may be a wise business proposition, and, if the Court had power to take hold of these things and do for the people, who are mortgage bondholders, that which it thinks best for them, we might have no hesitation in sustaining this; but every man in this country decides questions in respect to his own property for himself" (l. c. 929).

The result would have been the same, had the plan provided equality for the new mortgage instead of superiority.

The general creditor has a vested interest. The chancellor cannot destroy or impair it, except in accordance with equitable principles, any more than he can destroy or impair the bondholder's vested interest. He cannot—merely because he thinks it a good business proposition, or even because he thinks it to the advantage of the creditor—require the creditor to accept either inferiority to or equality with the stockholder, over whom he has a vested right to priority (Cf. *In re Prudential Outfitting Company,* 250 Fed. 504).

Furthermore, if the rule were that the creditor must be satisfied with securities of the same grade and rank as the old stockholder, *how much* more must the creditor be offered? If it is enough that he get one-third of his claim in preferred stock and the rest in common, why is not one-twentieth in preferred enough? Or, if he is offered participation on the same terms as a stockholder, but permitted to pay $2 less per $100 for his bonds, why cannot he not be required to accept such participation upon payment of only 2 cents less for his bonds. If he cannot be required to accept these extreme propositions, where is the line to be drawn? By what percentage must his participation exceed the stockholder's in quantity or value? What is the "fixed principle" by which the creditor's rights in such cases are to be determined?

Suppose a plan of re-organization provided that the creditors should be offered twenty-five cents on the dollar in cash and that the stockholders should be paid twenty cents or fifteen cents for every dollar of par value of stock, would anyone contend that such a plan

would be good under the Boyd case? Would not the creditor be entitled to say to the stockholder: "If there is only forty or forty-five cents left for both of us, I am entitled to all of it, because I am prior to you." And yet, what is the difference in principle between such a plan and that contended for by opposing counsel? In each case, the creditor gets a little more than the stockholder, but his priority is not preserved.

This Court in the Boyd case and the Monon case, did not say that a *part* of the creditor's interest must be preserved, but the plain implication is that if *any* interest of the stockholder is preserved, then *all* the interest of the creditor must be preserved. To preserve is to "keep intact or in existence" (Webster). *All* of the interest of the creditor is not preserved by giving him a fraction of his claim in cash, nor by giving him securities which are, in whole or in part, of the same rank as those given the stockholder. *All* of the interest of the creditor *is* preserved, if he is given securities which, for the full amount of the creditor's claim, rank ahead of the securities received by the stockholder—even though the creditor may thereby be compelled to *defer* realizing upon his claim.

It will doubtless be argued that the creditor may sometimes get more in market value by a mixed offer than he would by taking a preferred security. It is difficult to see how this could be the case, unless the interest or dividend on the preferred security were purposely and in bad faith made excessively low in order to depress its value. But, even if under normal conditions the result suggested should follow, the answer is that

the creditor, then, should have his choice to take the mess of pottage in place of his birthright. He should not have his birthright taken away and the delectable pottage substituted by someone else. He should be given the option to take his preferred security or the more speculative participation. As Mr. Justice Brewer said in *Merchants Loan and Trust Company* v. *Chicago Railways Company*, 158 Fed. 923:

> "Although it," [the Court] "may believe that a party insisting upon those rights" [his strict legal rights] "is probably, or even certainly, bound to suffer loss, yet while he insists it must protect him in his insistence" (l. c. 927).

It will not do to say that it is impracticable to preserve the normal relation between creditor and stockholder, or, as Judge Jenkins said in the Paton case, with reference to requiring *any* provision for the general creditor:

> "If such conclusion results from the decision in the Howard Case, the result must prove disastrous, uprooting past re-organizations of great magnitude, and seriously crippling, if not preventing, any future re-organization of bankrupt corporations" (85 Fed. l. c. 840).

The dire results predicted by Judge Jenkins have not followed, and that they will not follow from applying the rule in the Boyd case according to its intent is demonstrated by past history. As early as 1882, the income bond method was successfully applied (*Hancock* v. *Toledo etc., R. Co.*, 11 Biss. 148, 9 Fed. 738), and the preferred stock method has been successfully followed, as we have noted, in the two largest railroad re-or-

ganizations of recent years, the Missouri Pacific and the Rock Island (280 Fed. 38; 284 Fed. 945).

That the rights of the creditor must be determined by a fixed principle is clear, and the only fixed principle which is at all consistent with previously existing principles of equity is that with requires the priority of the creditor to be preserved. In fact, no one has attempted to suggest any other principle which does not resolve itself into an exercise of "unlimited discretion" by the chancellor and his fellow judges on appeal.

The rule which requires the preservation, in the re-organization, of the normal relation between the general creditor and the stockholder not only is more consonant with general equitable principles and with the need for a "fixed principle" expressed in the Boyd case. It is more convenient in practical operation. It lets re-organization managers know in advance what they can do, and it lets creditors know what their rights are and what they are not. Many general creditors in the past have sacrificed their rights through not knowing what they were, or not being willing to spend the money to enforce them. The history of the Boyd case and of the Kansas City Southern case illustrate the superhuman perseverance of those creditors who have insisted on their rights. If the rule suggested by the Boyd case, that the normal relation between general creditors and stockholders must be preserved through the re-organization, is firmly established, then there need be no further litigation. "He who runs may read."

Under the other rule, re-organization managers will be under a constant temptation to whittle the creditors'

participation down to the lowest percentage over the stockholders' participation which they think the particular chancellor in charge of the foreclosure will approve. And some chancellors, proud of a successful receivership administration and eager for an equally successful re-organization to result, will, perhaps, be unduly impressed by the idea that the re-organization will be hampered if the creditors are given too much. In any event, the chancellor will be compelled to make a general finding as to whether the offer is "fair," without any rule whatever to guide him. And thus, unless this Court firmly establishes a fixed principle to be followed by courts as well as parties, the liberal but wholesome dictum of the Boyd case may become a meaningless phrase, and the rights of creditors made to depend, not on a fixed principle of equity, but upon an individual's idea as to whether the creditors have been fairly treated, or, in the language of the Circuit Court of Appeals in presenting the questions now before the Court, whether "the offer tenders to such creditors all that could reasonably be expected under all of the existing circumstances."

The creditor, under such a rule, would face an impossible task. He would have to investigate the entire history of the receivership, foreclosure and re-organization, the whole financial structure of the company, and the values of all its properties—involving an expense, enormous even to organizations of security holders, and prohibitive to the individual general creditor. After all this had been done, he would, perforce, have to submit the evidence to a chancellor, who must determine from

it whether the creditor had been "fairly" treated, and neither the creditor nor the chancellor would have any standard by which fairness or unfairness could be determined. As a practical matter, the creditor would have to take what was offered him, whatever he might think of the fairness of the offer. He could not hazard his entire claim on a guess as to what the chancellor might consider "fair."

The need of a *fixed principle* by which the rights of the parties can be determined is forcibly expressed by Mr. Paul D. Cravath in his monograph on re-organizations above referred to:

> "It must earnestly be hoped that before long the Supreme Court will have an opportunity of handing down a decision which will supplement its decision in the Boyd Case, by indicating some fixed principles to be applied in making provision for the floating debt in re-organizations based upon the foreclosure of mortgages which offer participation to stockholders" (Some Legal Phases of Corporate Financing, Re-organization, and Regulation, p. 197).

The issuance of this certificate by the Circuit Court of Appeals for the Eighth Circuit Court implies the same hope.

Effect of Assessment.

Question III propounded by the Circuit Court of Appeals contains as an hypothesis the payment of an assessment by the stockholder.

What is meant by an assessment and what is its effect?

In the Boyd case, holders of preferred stock were assessed $10 a share and holders of common stock $15 a share, and they got nothing for the assessments except the right to participate in the re-organization by exchanging their old stock for new stock (l. c. 489). The payment of these assessments did not affect the Court's conclusion in any way. As Mr. Cravath says, with reference to the Boyd case in the monograph already referred to:

> "The moment they provided for participation in the new company by the stockholders, even at the price of paying a heavy assessment, the obligation arose to make provision for the unsecured debt which would recognize its priority to the interest of the stockholders" (p. 193).

In most cases, however, the "assessment" is not really an assessment at all, because the stockholder gets for it bonds or other preferred securities to the full amount of his payment.

To quote Mr. Cravath again:

> "I have used the term 'assessment' as describing the payment required of stockholders and others interested in the equity as a condition to their participation in a re-organization, because it is the term commonly used. It is, however, inaccurate, inasmuch as on final analysis the opportunity offered is to purchase from the Committee a portion of the securities which are to be issued to it by the new company in return for the property acquired and for the cash provided under the plan. It is simply a sale of securities" (p. 183).

And Judge Hook says in *Guaranty Trust Company* v. *Missouri Pacific Railway Company*, 238 Fed. 812:

> "In this case the old stockholders are required to pay in cash 50 per cent of the par of their holdings. They will receive for their cash payments new 4 per cent bonds at par. In order, these bonds will come just ahead of the preferred stock. They will be inferior to all the other bonded indebtedness, and their subordinate position in that respect, and their rate of interest, taken together, make it doubtful that they will soon, if ever, be worth par. *This will operate as an assessment upon the common stock to the amount of the discount.* That the stockholders will be given bonds for their cash payments is not inequitable to general creditors. They will pay more than they will get in value; but if they paid nothing, and received no bonds, still the relation between them and general creditors would not be disturbed" (l. c. 818).

In the case at bar, the holders of the preferred stock of the old company paid $20 a share and received $14 in Prior Lien 6% Bonds and $6 in Adjustment Mortgage Bonds, and the holders of common stock, $25 a share, for which they received $17.50 in Prior Lien 6% Bonds and $7.50 in Adjustment Mortgage Bonds—in each case, bonds to the full amount of the cash payment (Certificate, p. 2). They were assessed, therefore, only to the extent that what they paid for was worth less than par. A reference to the bond quotations on the New York Stock Exchange will show that the Prior Lien 6% Bonds since the first of the present calendar year (February 1st, 1926) have sold as high as 104⅛ and the Adjustment Mortgage Bonds as high as 95. While they were doubtless worth less at the time of their issuance, it is apparent that the stockholders did not sacrifice much in buying the bonds. In fact one who held them and sold at the prices quoted would have made a small profit.

In this case even more than ordinarily, therefore, the assessment can be ignored. It is never important, except as it reduces the participation of the stockholder, and, in this case, it reduced his participation very little.

On the other hand it may be, as indicated by Judge Hook, that the fact that the stockholder gets for his cash payment a security which is prior to the security given the general creditor does not invalidate the offer to the latter, *provided* the prior security is sold to him in good faith for full value not less than par and is not merely used as a subterfuge to give him a priority over the creditor, by reason of his being a stockholder of the old company.

Offer in Missouri, Kansas and Texas Reorganization.

The Re-organization plan and the offer in this case, as set forth in the certificate, (Certificate, pp. 2, 3), illustrate our argument very aptly.

The stockholders of the old company were called upon to pay as a condition of participation:

Owners of preferred stock, $20. per share,

Owners of common stock, $25. per share.

Each stockholder was entitled to receive upon surrendering his old stock and making the above payment—Holder of preferred stock for each share—

$14. in Prior Lien 6% Bonds,

$ 6. in Adjustment Mortgage Bonds,

1 Share of Common Stock.

Holder of common stock for each share—

$17.50 in Prior Lien 6% Bonds,

$7.50 in Adjustment Mortgage Bonds,

1 Share of common stock.

Creditors were offered—

Offer "A"—

For each $100 of claim: One-third of a share of preferred stock par value $100. a share, and two-thirds of a share of common stock.

Offer "B"—

For each $100. of claim: $14. in Prior Lien 6% Bonds, $6. in Adjustment Mortgage Bonds and one share of common stock, but only upon payment of $18.

The stockholder thus exchanged his stock for new stock upon condition that he should pay a certain amount of cash, for every dollar of which, however, he secured at par a lien prior to the creditor's interest.

The creditor got, for his claim, either (a) one-third preferred stock and two-thirds common stock, or (b) the privilege of participating in exactly the same manner as the holders of preferred stock, except that he had to pay $18 per $100 of claim for the privilege, instead of the $20 paid by the stockholder.

Let us compare Offer A with the provision for stockholders:

OFFER A—

Each general creditor of the old company gets one-third of a share of preferred stock and two-thirds of a share of common stock in the new company for each $100 of the amount of his claim. Each holder of one

share of the preferred stock of the old company gets one share of common stock of the new company, and each holder of one share of the common stock of the old company likewise gets one share of common stock of the new company. Hence, the general creditor is preferred over the holders of the preferred and common stock of the old company as to one-third of the amount of his claim, *but as to two-thirds of the amount of his claim the general creditor is not preferred* but stands upon an equal footing with the holders of the preferred and common stock of the old company. Thus, as to two-thirds of the amount of the general creditor's claim, the old stockholders have been promoted by the reorganization plan from their former position of inferiority to the creditor to a standing of equality with the creditor in the new company. Formerly, the general creditor was superior in right and prior in lien to all the stockholders of the old company as to the entire amount of his claim. By the reorganization, the creditor has lost this superiority and priority as to two-thirds of his claim, and, what he has thus lost, the stockholders of the old company have gained.

The fact that the stockholders of the old company are required to pay certain amounts as conditions to their participation is no justification for their being advanced to a position of equality with the general creditor. For every dollar of their so-called assessments, the stockholders have been given bonds of equal par value, which, through their lien, preserve to the stockholders an interest in the assets of the new company prior to everything which the creditor gets in the reorganization.

Lest it be thought that, by the assessment, the stockholder has added something to the assets of the company, to which the creditor as a stockholder in the new company may resort, it should be observed that, through his bonds, the stockholder has preserved a right in himself to resort to the assets ahead of the creditor to the amount of every penny of the assessment which he has paid. It is true that, by the assessment, the stockholder has added something to the assets of the new company, but through the bonds, he has carefully preserved all these additional assets for himself. He has reserved the right to take back what he has given, thus leaving nothing to which the creditor, as a stockholder in the new company, can resort.

OFFER B.

Boiled down, this offer means that the creditor would get $20 par value of bonds for $18. The holder of preferred stock would get precisely the same thing but he would have to pay $20 for it, instead of $18. In other words, the creditor has the advantage to the extent of 2% of his claim. The holder of common stock pays $7 more than the creditor, but he get $5 more in bonds than does the creditor. So that the spread between the creditor and the holder of common stock is but very little more than that between the creditor and the holder of preferred stock. Furthermore, Offer B involves the payment of money by the creditor as a condition precedent to the preservation of any part of his interest. An arrangement which makes the payment of money by the creditor a condition precedent to his participation

and at the same time preserves the stockholder's interest obviously cannot affect the creditor's rights. A creditor cannot be required to pay for the privilege of having his interest preserved as against the stockholder's. As an offer Offer B is a nullity.

It is apparent from these comparisons that the "normal relation between the two, general creditor and stockholder" is not preserved. Under Offer A, the creditor is preferred as to only one-third of his claim. Under Offer B, he is not preferred at all; he is merely given the same participation as the stockholder upon slightly better terms. Offer B is invalid, because it attempts to make the creditor's interest conditional upon his paying something to preserve it, while the interest of the stockholder is preserved; and both offers are invalid, because the normal relation between creditor and stockholder is not preserved.

To determine the comparative worth of the respective provisions for creditors and stockholders on the basis of these offers, would require a hearing in regard to values, a consideration of market reports on various dates, and difficult questions as to what date should govern, the presence or absence of manipulation, the value of the property back of the stock—in fact, all the questions which this Court in the Boyd case said that the creditor ought not to have to go into.

"Generally the objection to a plan of reorganization should involve a definite principle, and not require a long complicated investigation of values, properties, etc." (238 Fed. 818). So the principle on which an offer to creditors under a reorganization plan is based

ought to be so definite that the creditor does not have to institute a "long complicated investigation of values, properties, etc."— for him an impracticable, if not impossible task, as we have seen.

The certificate does not state the market prices of the securities of the new M-K-T Company. But it is obvious that, whatever they were, they would probably fluctuate widely from one date to another, and that comparisons would differ according to the date selected for comparison.

Even after the difference in value between what the creditor got and what the stockholder got had been ascertained, however, the court would have no fixed principle by which to determine whether the creditor had gotten what he was entitled to. Must he get 1%, 2%, 10%, 20%, 40%, 50%, 75%, 90% or 100% more than the stockholder? The chancellor could only try to guess whether, in the language of Questions II and III, "the offer tenders to such creditors all that could be reasonably expected under all of the existing circumstances."

In *Wabash Railway Company* v. *Marshall*, 224 Mich. 593, an offer to creditors in the Wabash reorganization, very like the offer in the M. K. & T. reorganization (25% preferred stock and 75% common stock) was held insufficient under the Boyd case.

Interest.

It will also be argued that the offer in the instant case is particularly meritorious, because it includes a certain amount of interest for the creditor. The interest included was up to a date about six months before

the entry of the foreclosure decree and over a year before the conveyance of the property to the new company (Certificate, p. 3).

The inclusion of interest was no more than the creditor's right. In fact, it was a little less. He was entitled to interest at least to the date when he could receive his securities under the offer (See *Phipps* v. *Chicago Rock Island & Pacific Railway Company,* 284 Fed. 945, 946, 947).

Since the case of *American Iron Company* v. *Seaboard Air Line Railway,* 233 U. S. 261, it is settled that the rule stopping interest on the appointment of a receiver is one of convenience, only, to facilitate distribution among creditors of the same class, and that it has no application to controversies between those of superior and inferior rank. As against the corporation and its stockholders, the creditor, as a matter of right, can insist upon interest in full. The Court says:

> "But that is not because the claims had lost their interest-bearing quality during that period, but is a necessary and enforced rule of distribution, due to the fact that in case of receiverships the assets are generally insufficient to pay debts in full. * * * For that and like reasons, in case funds are not sufficient to pay claims of equal dignity, the distribution is made only on the basis of the principal of the debt. But that rule did not prevent the running of interest during the Receivership; and if as a result of good fortune or good management, the estate proved sufficient to discharge the claims in full, interest as well as principal should be paid" (l. c. 266).

The general rule is thus stated by a distinguished text writer (II Tardy's Smith on Receivers, 2nd Ed. Sec. 598):

> "As against the receivership debtor, and, in case of a corporation *as against the corporation* itself *and its stockholders*, all creditors are entitled to be paid in full with interest to the time of payment and will be so paid if the funds are sufficient."

Furthermore, in the reorganization involved in *Hancock* v. *Toledo, etc. R. R. Co.*, 11 Biss. 148, 9 Fed. 738, the amount for which income bonds were issued to the general creditors included interest in full, and, in the Rock Island reorganization (*Phipps* v. *Chicago, Rock Island and Pacific Ry. Co.*, 284 Fed. 945, 946), interest up to the date for delivery of securities was paid in cash. The report of the Missouri Pacific Case (280 Fed. 38) does not state whether interest was included. Whether it was or not, the appellants in that case did not raise the point.

The reorganization managers in the case at bar, therefore, have conferred no favor upon the creditors by permitting a certain amount of interest to be included in the computations upon which securities were to be issued under the offer to creditors.

Conclusion.

We submit that the only sound rule is the one which requires the offer to general creditors to preserve the creditors' rank over the stockholders by some form of

security which has priority over the stockholders' interest, both as to principal and income.

(1) It involves the least departure from the ordinary equitable principles that a voluntary transferee, a mortgagor buying at his own sale, or an owner buying in at a tax sale takes the property purchased subject to all claims against it.

(2) It is in accord with the spirit of the Boyd case and also with the language of the Boyd case so far as the latter goes.

(3) It establishes a "fixed principle" by which the fairness of an offer may be determined. Any other rule leaves the question to be determined more or less according to the whim of the individual chancellor administering the property.

(4) It makes for uniformity.

(5) It enables reorganization managers to know what they can do and it enables creditors to know what are their rights.

(6) It is a thoroughly practical rule, tested in important railroad reorganizations.

(7) It is fundamentally sound and just.

The Questions.

If our argument is sound, it follows that all three questions ought to be answered in the negative, but, perhaps, with the qualification as to Question I: "except that the stockholder may have precedence over the credi-

tor so far only as he shall receive prior lien securities, for which, by way of assessment or otherwise, he shall have subscribed and paid full value, not less than par."

We respectfully urge that they be so answered.

Respectfully submitted,

EDWARD J. WHITE,
N. H. LOOMIS,
BRUCE SCOTT,
GARDINER LATHROP,
SAMUEL W. SAWYER,
Counsel for Kansas City Terminal Railway Company, et al.

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No. 265.

In the Supreme Court of the United States

OCTOBER TERM, 1925.

KANSAS CITY TERMINAL RAILWAY COMPANY, ET AL,

VS.

CENTRAL UNION TRUST COMPANY OF NEW YORK, ET AL.

ON CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

REPLY BRIEF OF KANSAS CITY TERMINAL RAILWAY COMPANY ET AL.

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SAMUEL W. SAWYER,
Counsel for Kansas City Terminal Railway Company, et al.

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As anticipated in our original brief, our opponents suggest no principle by which to determine the "fairness" of an offer to creditors. The substance of their argument is that the chancellor should have discretion to decide how much more "in value" the creditor is to get than the stockholder, with no guiding principle or standard.

In support of this theory, they rely upon expressions in three judicial opinions. (*North American Company*

v. *St. Louis & San Francisco Railway Company*, printed as an appendix to their brief; *Western Union Telegraph Company* v. *United States & Mexican Trust Company*, 221 Fed. 545, 549; *Phipps* v. *Chicago, Rock Island & Pacific Railway Company*, 284 Fed. 945, 948.) All of these opinions are by the judge from whose decree the appeal in the case at bar was taken. His remarks *arguendo* gain no added weight by their repetition. They are an expression of opinion by the court below, no more. It is true that in the Western Union case and in the Phipps case, Judge Sanborn was sitting in the Circuit Court of Appeals, but in neither case was a precise statement of principle necessary to the decision.

In the Western Union case no offer at all was made to creditors and the decree of the lower court was reversed because it did not permit an intervening creditor to attack the fairness of the plan on this account. There was no need for the court to define the limits of the doctrine and it did not undertake to do so. It was sufficient for disposing of the case to say, as the opinion did, that, if the stockholders were offered "benefits equal to or greater than" were the general creditors, the purchase was fraudulent in law.

In the Phipps case, the creditors were offered securities which had priority in all respects over the securities received by the stockholders. In such a case, a statement in the opinion that the creditors received interests "of much greater proportionate value" and "more beneficial proportionately" than the stockholders, is true but it does not purport to be comprehensive.

Counsel refer to *Lane* v. *Equitable Trust Company*, 262 Fed. 918, involving the Wabash re-organization plan, but in that case the creditor did not rely upon the doctrine of the Boyd case. His claim was that the trustees in the mortgage were not entitled to a deficiency judgment.

It is said that the term "fairness" is analogous to the term "fraud" (page 14) and, by inference, that what constitutes it, should be left to the "wisdom, knowledge and consciences" of judges. But the determination of what constitutes fraud has never been left to the "wisdom, knowledge and consciences" of judges. "What is fraud in a court of law, is fraud in a court of equity" (Smith on Fraud, Section 230, page 250), and the courts have never left it to juries or to individual chancellors to determine, in their discretion, what constitutes fraud. It is unnecessary to discuss so elementary a proposition in detail. It is sufficient to refer to a single opinion of this Court (*Southern Development Company* v. *Silva*, 125 U. S. 247) where Mr. Justice Lamar in affirming a decree dismissing a bill in equity for rescission on the ground of fraud lays down a set of principles which could more fairly be called a formula than could the principle which we have advocated in our original brief.

Another general term which is frequently used in the law, is "ordinary care." Yet the courts have not left its application to the discretion of juries and chancellors. On the contrary, definite principles as to what constitutes ordinary care were early adopted. Such rules as "the last clear chance," the "fellow

servant rule," "safe place to work," "stop, look and listen" and "*res ipsa loquitur*" are but illustrations.

The fact is, that "fraud," "ordinary care" and "fairness' are all general terms, and are useless unless definite principles are established by which the rights of parties may be determined with relative uniformity, rather than according to the varying standards of individual jurors and individual judges.

But, counsel say, and repeat throughout their brief, that we are endeavoring to establish a "formula" instead of a principle.

They have allowed this epithet to take the place of a real analysis of our contention.

Our contention is said to be that the general creditor must, in all cases, be given income bonds or preferred stock. Even if we had so contended, our contention would not merit the hated term "formula." It would merely be the statement of a definite principle for which excellent arguments could be advanced, and for which authority exists.

But we have not so contended. What we have asserted and do assert is, that the general creditor, wherever the stockholder is allowed to participate in the re-organization, must be given a participation which maintains his relative rank above the stockholder to the full amount of his claim. It matters not precisely how this is done. In the great majority of cases, it would undoubtedly be by the issuance of income bonds or preferred stock. In some cases, where the plan of re-organization is simple and the classes of secured creditors few, some form of second or third mortgage

bond might be used. In others, the creditors might possibly be given some form of common stock—provided the stockholder's participation was somehow inferior to such common stock. In some cases, the creditor might get first preferred stock; in other cases, second preferred stock; in some cases, first income bonds; and in other cases, second income bonds. A variety of participations might be given, provided the essential principle is maintained that the creditor must always rank ahead of the stockholder.

It is said that the creditor ought not to be interested in priority (page 26), and that the re-organization managers might render a preferred security of less value than a junior security, by giving it a very low rate of interest or dividend, or otherwise. We anticipated this contention in our original brief (pages 46 and 47). It is sufficient to say here, that the offer to the creditor must in all cases be made in good faith and that the return on his security, for which he has preference over the stockholder, must bear some relation to the prevailing rates for money at the time.

It is next said (pages 12, 13 and 31) that there may be not sufficient property value to support the issuance of preferred stock and income bonds, and that re-organizations might become impossible. The latter argument was made and met in the Boyd case. The former answers itself. If there is no value to support the securities to be issued to the creditors, then, *a fortiori* there is no value to support the issuance of securities to the stockholders. If there is any value whatever to support the stockholders' securities, then

there must necessarily be a value to support the creditors' securities. As this Court said in the Boyd case (l. c. 508), "If the value of the road justified the issuance of stock in exchange for old shares, the creditors were entitled to the benefit of that value, whether it was present or prospective, for dividends or only for purposes of control. In either event, it was a right of property out of which the creditors were entitled to be paid before the stockholders could retain it for any purpose whatever." In making their argument, counsel have not only overlooked the above considerations, but also the fact that preferred stock, as well as common stock, under the laws of many of the states, may be issued without par value, and that income bonds do not purport to represent any property value. If, however, there were any difficulty, there are various ways in which it could be readily met. A good illustration may be found in the plan of re-organization of the Metropolitan Street Railway Company and allied companies in Kansas City, prepared by Judge William C. Hook of the Eighth Circuit, who was in charge of the receivership. In the plan, he incorporated the following provision:

> "(d) So that no person having a just demand against any of the street railway companies or the 'Railway' shall be denied participation in the reorganization, the 'New Company' shall, from time to time, as occasion requires, issue 'Special Deferred Securities' for all claims, liquidated by agreement or established by decree in the pending cases, which are inferior in right to the old bonds, but superior to the stock, and for which provision is not otherwise made in this plan. These securi-

ties shall run for the life of the 'Franchise,' and bear 6% interest, cumulative, and payable only out of the net earnings of the company. In no case shall the amount exceed the sum or sums liquidated, and they shall be tenderable in discharge thereof at par. They shall not constitute a lien upon the physical property of the 'New Company,' but their status shall be, as against the owners of the stock, substantially similar to that of preferred stock. Inasmuch as equitable provision has been made herein for all funded obligations of the old companies, these securities shall not be available for deficiency judgments in foreclosure or balances after application of proceeds of sales under collateral trusts."

(District Court Western Division, Western District of Missouri, *Kansas City Railway & Light Co.* v. *Metropolitan Street Railway Co.*, in Equity No. 3720, Vol. II, printed record p. 1633, filed August 16, 1915.)

Counsel suggest difficulties in obtaining the approval of securities by the Interstate Commerce Commission under Section 20a of the Interstate Commerce Act as amended by the Transportation Act of 1920. But it is inconceivable that the commission would find the preference of creditors over stockholders not "compatible with the public interest."

It is also said that the principle may be unjust to the bondholder because in some cases he may have taken a part of his participation in stock (page 28). That is a matter which is in the bondholder's power. He need leave nothing for the creditor in the ordinary case, provided he makes no agreement with the stockholder. If by agreement with the stockholder he accepts less than is his right, he has presumably received

a consideration for his concession. If he agrees to accept stock for a part of his claim, he has made his own bed. Furthermore, it would always be practicable, by dividing the different classes of stock into ranks, to give the bondholder stock which would rank above that given the general creditor. It should also be observed that the creditor does not bear the same relation to the bondholder as does the stockholder to the creditor. The creditor is not the mortgagor and owes no obligation whatsoever to the bondholder. If the bondholder chooses to make an agreement with the stockholder, he does so with his eyes open to the consequences, and the creditor owes him no duty with reference to the corporate property. The stockholder, on the other hand, is under an obligation to the creditor analogous to a trust (*Railway Company* v. *Howard*, 7 Wall. 392, 411). He is the mortgagor, and, if he acquires an interest in any manner, it must be in subordination to the creditor's claim (228 U. S. l. c. 504).

The truth is, that the principle which we have advocated, results almost inevitably from the nature of the situation. A court of equity takes from the creditor that which ordinarily is rightfully his, and gives it to the debtor. In doing so, the court undertakes to give the creditor, as a substitute for the direct resort to the property, to which he would otherwise be entitled, something which will preserve his right, but deprive him of the power to enforce it arbitrarily. Logically, he ought to be put in substantially the same position in the new company relatively to the stockholder, as he occupied in the old company (deprived,

however, of the right to a cash satisfaction of his claim) or, in the language of the court in *Guaranty Trust Company* v. *Missouri Pacific Railway Company*, 238 Fed. l. c. 818—"the normal relation between the two, general creditor and stockholder," should be preserved. It is not impracticable nor even difficult to do so. The court judicially knows that most receiverships, and virtually all foreclosures are brought about, not by inability to meet the floated indebtedness, but by difficulties in meeting heavy loads of interest on bonded indebtedness, and that, while such receiverships ordinarily begin with a creditor's bill, the defendant enters its appearance, confesses the allegations of the bill, and foreclosure suits immediately follow. In other words, the creditor's bill is but an incident to the foreclosure. (See an excellent monograph by Mr. James Byrne, on the Foreclosure of Railroad Mortgages contained in "Some Legal Phases of Corporate Financing, Re-organization and Regulation," by Francis Lynde Stetson and others, pp. 77, 79.) The floating indebtedness is ordinarily small compared to the secured indebtedness. Much of it is bought up for cash by the reorganization managers and retired, as in the Boyd case, and the total amount of securities which would have to be issued on account of it would be relatively slight.

This principle has been followed in several of the largest railroad reorganizations in the country, as we pointed out in our original brief, and in others it could have been followed with comparatively slight modifications of the plan and without any serious detriment to the effectiveness of the plan.

Counsel refer triumphantly to the fact that, in the Boyd case, preferred stockholders of the old company received preferred stock in the new company (pages 18 and 48). They find, in this, evidence that the court in the Boyd case, did not mean that creditors should retain their priority in the new company. For, they say, how could the creditors have priority, if they received preferred stock, where the preferred stockholders also received preferred stock? This is plausible, but of no force. It would be very simple, as we have pointed out, to give the creditors a first preferred stock, and the preferred stockholders a second preferred stock, and this is, in all probability, precisely what Mr. Justice Lamar would have said, had the question been raised.

Counsel say at page 36 with reference to the Boyd case: "It is not derived from the rule that a mortgagor may not buy in at his own mortgage sale and cut off intervening rights, but is a separate and distinct equitable principle, an example of equity's power to make exceptions to legal rules in order to secure equity." This court said in the Boyd case (l. c. 504): "Being bound for the debts, the purchase of their property, by their new company, for their benefit, put the stockholders in the position of a mortgagor buying at his own sale." And again (l. c. 506): "As against creditors, it was a mere form. Though the Northern Pacific Railroad was divested of the legal title, the old stockholders were still owners of the same railroad encumbered by the same debts. The circumlocution did not better their title against Boyd as a

non-assenting creditor. They had changed the name, but not the relation. The property in the hands of the former owners under a new charter was as much subject to any existing liability, as that of a defendant who buys his own property at a tax sale." Further comment is unnecessary.

Counsel argue (pages 28 and 29) that, since the bondholders in reorganizations usually concede something to procure the adherence of the stockholders, what the stockholders get thereby should be deemed to have been obtained at the expense of the bondholders and not of the unsecured creditors, and they quote a sentence from Fletcher's Cyclopedia of Corporations to the effect that, in such a case, the secured creditors cannot complain. This quotation, however, as will be seen from the foot note in the Cyclopedia, is based upon the case of *Farmers Loan and Trust Company* v. *Louisville, etc., Railway Company,* 103 Fed. 110, decided by Circuit Judge Woods in the District of Indiana (see page 24 of our original brief) and afterwards disapproved by this court in the Boyd case (228 U. S. l. c. 503). The Monon case and the Boyd case make it clear that, if the bondholder chooses to depart from his right to a strict foreclosure by giving an interest in the property to the stockholder for the purpose of securing his consent to the foreclosure or of obtaining new money for the enterprise, neither the stockholder nor the new company can set up the alleged sacrifices of the bondholders in diminution of the rights of unsecured creditors. As this Court said in the Monon case:

> "It is one thing for a bondholder who has acquired absolute title by foreclosure to mortgaged property to thereafter give of his interest to others, and an entirely different thing whether such bondholder, to destroy the interest of all unsecured creditors, to secure a waiver of all objections on the part of the stockholder and consummate speedily the foreclosure, may proffer to him an interest in the property after the foreclosure" (174 U. S., l. c. 688).

To support their argument in favor of the unlimited discretion of the chancellor as against definite principles, counsel suggest at page 43 that differences in value of the property make a constant principle impracticable of application—notwithstanding the express statement in the Boyd case that "the invalidity of the sale flowed from the character of the reorganization agreement regardless of the value of the property" (228 U. S. l. c. 507). They say, "In the Boyd case no contention apparently was made that the value of the property after providing for the mortgaged debt was insufficient to pay the mortgaged debt and accordingly, this Court did not decide that the creditor's right to go against the new company was independent of the value of the property." We leave counsel to explain how this statement can be reconciled with the following from the opinion in the Boyd case:

> "It is insisted, however, that not only the bid at public outcry, but the specific finding in the Paton case, established that the property was worth less than the encumbrances of $157,000,000, and hence that Boyd is no worse off than if

the sale had been made without the reorganization agreement" (228 U. S. l. c. 507).

The Guardian Trust Company case is next referred to, seemingly with the view of distinguishing or nullifying the Boyd case (page 43). It needs no argument to show that the Guardian Trust Company case is wholly consistent with the Boyd case. In the Guardian Trust Company case there was a reason for considering value which did not exist in the Boyd case—namely personal liability was decreed. But that it was unnecessary for the Court to ascertain the precise value of the property is evident from the last sentence of the second paragraph on page 176, where the Court says, "It appears to us that while perhaps *not justifying definite figures*, the reasoning warrants the belief that there was an equity for which the appellant must account" (240 U. S. l. c. 176) (Italics ours).

Both cases seem to recognize that the provision of stock for the old stockholders establishes that there is an equity. Both cases make it clear that, if there is an equity, the stockholders cannot participate, except in subordination to the creditors, and that the principle is not altered by variations in the exact value of the equity. "If their interest is valueless, he gets nothing. If it be valuable, he merely subjects that which the law had originally and continuously made liable for the payment of corporate liabilities" (228 U. S. l. c. 508).

Counsel seem to intimate on pages 39 to 42 of their brief that matters relative to preferential claims and receiver's certificates are largely controlled by the

discretion of the chancellor. Receiver's certificates need not be discussed, since they are issued by the courts as an administrative function rather than in the course of adjudicating controverted rights.

As to preferential claims, this Court, in *Kneeland* v. *American Loan & Trust Co.*, 136 U. S. 89, carefully pointed out that unsecured claims were entitled to priority only in a few "specified and limited cases" (l. c. 97), and warned counsel and the courts against the growing idea "that the chancellor, in the exercise of his equitable powers, has unlimited discretion in this matter of the displacement of vested liens" (l. c. 98).

The definiteness with which these priorities have been "specified and limited" is illustrated by the terse summary by Mr. James Byrne in his able monograph on Foreclosures of Railroad Mortgages (already referred to), at page 123, where he sums up in three simple rules the net result of the decisions of this Court and of the other federal courts on the subject.

In two or three places in their brief, opposing counsel assume that the Circuit Court of Appeals, in propounding the questions certified, intended to express its opinion that the offer to creditors in the case at bar was in fact fair. Of course, nothing of the sort was intended. That court attached the provisos to Question II and Question III so that all matters of fact should be eliminated from the questions, leaving for this Court's determination only propositions of law, in accordance with the statute and the rules of this Court.

Our opponent's brief, we repeat, lacks any suggestion of definite principle by which to determine how much more a creditor should get than a stockholder. They simply say that he should get as much or more. How much more is, presumably, to be left to the discretion of the chancellor. The rule which we have suggested not only furnishes a fixed and definite principle, but it is thoroughly consistent with the equitable principles out of which the Boyd case grew. It makes the doctrine of the Boyd case what it was intended to be, a relaxation of the equitable doctrine established by the Howard case and others and repeated by this Court in the Pierce case, that a corporation cannot transfer its assets to another corporation consisting of the same stockholders and thereby free its assets from the claim of creditors. To leave the whole question to the unlimited discretion of the chancellor is not to relax the doctrine, but to shatter it.

As this Court said in *Hollon Parker, Petitioner*, 131 U. S. 221, 225, "Rights under our system of law and procedure do not rest in the discretionary authority of any officer, judicial or otherwise."

Respectfully submitted,

EDWARD J. WHITE,
N. H. LOOMIS,
BRUCE SCOTT,
GARDINER LATHROP,
SAMUEL W. SAWYER,

Counsel for Kansas City Terminal Railway Company, et al.

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Supreme Court of the United States

OCTOBER TERM, 1925.

No. 265.

KANSAS CITY TERMINAL RAILWAY COMPANY et al.,
Appellants,

vs.

CENTRAL UNION TRUST COMPANY OF NEW YORK
Trustee, et al.,
Appellees.

On Certificate from the Circuit Court of Appeals for the Eighth Circuit.

BRIEF FOR CENTRAL UNION TRUST COMPANY OF NEW YORK ET AL.

ST. LOUIS LAW PRINTING CO., 415 North Eighth Street. Central 4477.

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Supreme Court of the United States

OCTOBER TERM, 1925.

No. 265.

KANSAS CITY TERMINAL RAILWAY COMPANY et al.,
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Trustee, et al.,
Appellees.

On Certificate from the Circuit Court of Appeals for the Eighth Circuit.

STATEMENT.

The United States Circuit Court of Appeals for the Eighth Circuit, by an order dated January 22, 1925, certified to this Court three questions or propositions of law under Section 239 of the Judicial Code, concerning which it desired the instruction of this Court for their proper decision.

Included in the certificate was a statement of the nature of the cause and of the facts on which such questions or propositions arose.

Thereafter the Kansas City Terminal Railway Company and others, appellants, filed in this court a petition for writ of certiorari directed to said United States Circuit Court of Appeals for the Eighth Circuit, commanding said court to certify and send to this Court a full and complete transcript of the record of the proceedings in said Circuit Court of Appeals in the cause, "to the end that this Court may decide the whole matter in controversy in the same manner as if it had been brought to this Court for review by writ of error or appeal—all as provided in Section 239 of the Judicial Code and Rule 37 of the rules of this Court," and a brief in support thereof.

The Circuit Court of Appeals for the Eighth Circuit on April 25, 1925, filed an **amended certificate "in lieu** of the certificate heretofore filed in order that certain additional facts (deemed by the parties and this Court of use in determining the questions herein submitted) might be brought to the attention of the Court." In the **amended certificate** the **questions certified** were **exactly the same** as those certified in the original certificate, the difference between the original certificate and the amended certificate being **in the statement of the nature of the cause and of the facts under which the questions or propositions of law arose.** Said amended certificate reads as follows:

> "This amended certificate is presented, **in lieu of the certificate** heretofore filed, in order that certain

additional facts (deemed by the parties and this Court of use in determining the questions herein submitted) might be brought to the attention of the Court.

"The United States Circuit Court of Appeals for the Eighth Circuit hereby certifies that a record on an appeal now pending before it discloses the following:

"The Kansas City Terminal Railway Company and others filed an intervening petition in the receivership proceedings of the Missouri, Kansas & Texas Railway Company. That intervention sought to attach the obligations of passenger terminal contracts to the property in such a way that the obligations of these contracts would be either a lien on the property prior to all mortgage obligations, or would follow the property into the hands of any purchaser under foreclosure of the mortgages. It was determined by the District Court and affirmed by this Court (294 Fed. 32) that these terminal contracts were ordinary executory contracts entered into by the Missouri, Kansas & Texas Railway Company as aids to its operation.

"Thereafter, the property in receivership was sold under foreclosure. The purchase was in pursuance of a reorganization plan. This plan involved lienholders, unsecured creditors and stockholders. In so far as the plan affects lienholders it is not involved in this appeal. The points raised on this appeal relate to the **fairness of the offer to these interveners**, which were classed as **unsecured creditors. This plan was not submitted to the Court, but the offer to unsecured creditors, as contained therein, was submitted and approved. Their claim is that the stockholders were unduly preferred in this reorganization plan.**

"By the reorganization plan the new company was to have four classes of securities, as follows:

"Prior lien mortgage bonds (authorized issue $250,000,000).

"Cumulative adjustment mortgage bonds (authorized issue $100,000,000), which were **income bonds** secured by mortgage as to principal; preferred stock (authorized issue $200,000,000).

"Common stock without par value (authorized issue 2,500,000 shares).

"Of the above securities, certain amounts of each were reserved for future use by the new company. Of the prior lien bonds provided for distribution in the plan, some bore interest at 4 per cent, some at 5 per cent and some at 6 per cent, respectively.

"Under the reorganization plan new securities were offered to the holders of **seventeen separate issues** of outstanding **bonds** of the Missouri, Kansas & Texas Railway Company, and its various subsidiary companies secured by mortgage, and of **one issue of notes** secured by the pledge of mortgage bonds. In some cases, but not in all, cash was offered to the holders of these secured claims in addition to new securities. **In all cases** the par amount of the new securities offered (taking the new non par value common stock at $100 per share), plus the cash offered, if any, **equaled, and in no case did it exceed,** the principal amount of the old outstanding securities in respect of which the offer was made, **plus the unpaid interest thereon up to January 1, 1922.**

"Of said eighteen outstanding issues:

"Five issues were offered only new prior lien bonds and cash.

"One issue was offered only new prior lien bonds.

"Five issues were offered only new prior lien bonds and new adjustment bonds.

"Three issues were offered only new prior lien bonds, new adjustment bonds and **new preferred stock.**

"**One issue** was offered **only new adjustment bonds** and **new preferred stock.**

"**Three issues** were offered only new **adjustment bonds, new preferred stock** and **new common stock.**

"In all cases, the new prior lien bonds and the new adjustment bonds (whether offered to secured creditors, unsecured creditors or stockholders) **were to bear interest from January 1, 1922.**

"In so far as the reorganization plan affected **stockholders and unsecured creditors,** its provisions were substantially as follows: (1) Preferred stockholders were entitled to receive $14 in prior lien bonds (bearing 6 per cent interest), $6 in adjustment bonds and one share of common stock in the new company upon payment of $20 for each share of stock of the par value of $100 held in the old company. (2) Common stockholders were entitled to receive $17.50 in prior lien mortgage bonds (bearing 6 per cent interest), $7.50 in adjustment bonds and one share of common stock upon payment of $25 for each share of stock of the par value of $100 held in the old company. (3) Unsecured creditors were given the choice of two plans: (a) One-third of a share of preferred stock of the par value of $100 and two-thirds of a share of common stock without par value for each $100 of the aggregate amount of the claim, including interest to January 1, 1922, whereas the Receiver was appointed and took possession of the property on September 27, 1915, the foreclosure decree was entered on June 30, 1922; the offer to creditors was dated July 15, 1922;

the foreclosure sale was had on December 13, 1922; the order confirming the sale was entered February 9, 1923, and the order approving the Master's deed conveying the property to the new company was entered on March 10, 1923. (b) Fourteen dollars in prior lien mortgage 6 per cent bonds, $6 in adjustment mortgage bonds and one share of common stock upon payment of $18 for each $100 of said claim.

"**A claim made by appellants here is that** certain decisions of the Supreme Court of the United States (Northern Pacific Railway Company v. Boyd, 228 U. S. 482; Louisville Trust Company v. Louisville Railway Company, 174 U. S. 674) **require** that **an offer** in a reorganization plan, in order to **be a fair** and binding offer upon the creditor **must be one which will preserve** 'to the creditor his **relative priority over the stockholders.** It is **not sufficient that he should get a little more than the stockholder.** His **entire claim must** take **precedence** over **any part** of the interest of **a stockholder.** It is **not sufficient** that he be offered securities of the **same grade** as the **stockholder,** but a **trifle more in amount,** or that the **stockholder's right to participate be conditioned upon the payment of an assessment.'**

"It is further certified that the **following questions of law** arise from this record and are presented, the decision of which is indispensable to a determination of the case. To the end that this Court may properly discharge its duty, it desires the instruction of the Supreme Court upon them.

"Question I. Is a plan of reorganization of a railway company sufficient as to unsecured creditors and binding upon them which does not give precedence to the entire claim of the creditor over any part or interest of a stockholder in the old company?

"Question II. Is such a plan fair and binding upon such creditors even though they be offered securities of the same grade as the stockholders, the difference being only in the greater amount offered the creditor, provided the Court shall be of the opinion that the offer tenders to such creditor all that could reasonably be expected under all of the existing circumstances?

"Question III. Is such offer as to such creditors fair and binding if it consists **only** of the same grade of securities as offered the stockholders, the difference being that the right of the stockholder to participate is conditioned upon the payment of **an assessment**, or the payment of a relatively greater assessment, than that asked of such creditors, provided the Court shall be of the opinion that the offer tenders to such creditor all that could reasonably be expected under all of the existing circumstances?"

Thereafter this Court, on May 4, 1925, denied appellants' petition for writ of certiorari to bring up the whole record and cause (45 Sup. Ct. Rep. 512).

Counsel for appellants, since filing their brief, have written us that their statement that their motion was still pending was made in ignorance of the fact it had been denied.

This Court had previously (in 264 U. S. 588) denied appellants' petition for writ of certiorari to the United States Circuit Court of Appeals for the Eighth Circuit in the first appeal of Kansas City Terminal Railway Company referred to in the certificate (294 Fed. 32), wherein that Court held (as stated in the certificate) that the contracts sued upon did not constitute a lien on the property prior to all mortgage obligations and did not follow the property into the hands of the appellee purchasing com-

pany—Missouri-Kansas-Texas Railroad Company—and that they were nothing but ordinary executory contracts.

The earlier appeal of appellants is hereinafter for convenience called the first appeal.

The sole controversy in the present or second appeal is whether the offer made by the Reorganization Managers to unsecured creditors of the old company was a fair and reasonable offer. As stated in the certificate, the claim was made by appellants in the court below that "certain decisions of the Supreme Court of the United States (Northern Pacific Ry. Co. v. Boyd, 228 U. S. 482; Louisville Trust Co. v. Louisville Ry. Co., 174 U. S. 674) require that an offer in a reorganization plan, in order to be a fair and binding offer upon the creditor, must be one which will preserve 'to the creditor his **relative priority over the stockholder.** It is not sufficient that he should **get a little more than the stockholder.** His **entire claim** must **take precedence** over any part of the interest of a stockholder. It is not sufficient that he be offered **securities of the same grade** as the stockholder **but a trifle more in amount**, or that the **stockholder's right** to participate be conditioned upon the **payment of an assessment.**'" It was on account of these claims of appellants that the Circuit Court of Appeals certified to this court the three questions now before it.

Questions I and II, certified by the Circuit Court of Appeals, refer to the first of the two alternative offers to creditors under which creditors were entitled to receive, for each $100 of their claims, including interest to January 1, 1922, one-third of a share of preferred stock of the New

Company (par value $100) and two-thirds of a share of common stock without par value. This offer is hereinafter referred to as offer A. Question I is presumably based on the fact that creditors were offered one-third in preferred stock and two-thirds in common stock for their claims. The word "precedence" in this question must be taken to mean precedence in rank of securities, since it is admitted that "the entire claim of the creditor" was given precedence in value of securities and no stockholders received any preferred stock. Question II is apparently based on the fact that the creditors received proportionately more securities in amount than the stockholders (or indeed than bondholders), since they received securities in respect not only of principal, but also of interest after the receivership. Hence it is clear that the general creditor is preferred over both the old preferred and common stockholders. The preference applies to the whole of the general creditor's claim and not simply to one-third thereof as contended by appellants. The point of law raised by these questions is the same, viz., whether the test of a "fair and reasonable" offer is the comparative **value** of the securities offered to creditors and stockholders in a reorganization, or the relative **rank** of such securities in the corporate structure of the corporation resulting from the reorganization. It should be noted, however, that if question I is answered in the affirmative, the answer to question II is immaterial for this case.

Question III asks whether an offer to creditors may be "fair and reasonable" if creditors are offered securities

of the same grade as stockholders, both classes being required to pay by way of assessments for the securities they receive, the creditors, however, paying less than the stockholders. This refers to the alternative offer to creditors, giving them the option to purchase the same securities which the stockholders took, but for less money. This offer is hereinafter called offer "B." The creditor, therefore, had a choice of two offers. If he considered the offer to stockholders better than offer A to the creditors he could, at his election, accept offer B on better terms than the stockholders.

It is clear from the foregoing analysis of the questions certified by the Circuit Court of Appeals that only one substantial question of law is involved, namely, whether the test of a fair and reasonable offer is the value of the securities offered or their character. The subsidiary point raised by question III is only discussed briefly in view of the alternative offer made.

The question of the **actual** fairness of the offer, as distinguished from the **legal** fairness, i. e., whether, on the facts of this case, the new securities issuable in the reorganization were so distributed as to recognize equitably the respective interests of secured creditors, unsecured creditors and stockholders, is not before this Court. The questions certified by the Circuit Court of Appeals are stated to be based on the assumption that the offer "tenders to such creditor all that could reasonably be expected under all of the existing circumstances," that is that the offer was fair and reasonable, on fact.

SUMMARY OF THE ARGUMENT.

In its certified questions the court below has indicated its opinion that the offer tendered to creditors is all that could reasonably be expected in the circumstances. The question is, therefore, whether that offer, in itself fair and reasonable, must in this court be held to fail for not conforming to some fixed formula. The virtue of a formula is alleged to be that it will relieve chancellors, faced with intricate facts and complex financial questions in reorganization cases, of the difficult duty of deciding whether in the circumstances of practical affairs, offers are fair and reasonable. In the rigidity of the formula, appellants say, the unsecured creditor is to find the certain fairness of his treatment. What the formula is to be, they do not make clear. Apparently it is that everything given creditors must outrank anything given stockholders, and that creditors in these ranking securities must receive their whole claims, principal and interest. On appellants' theory of formula they find no merit in the value granted creditors exceeding that allowed to stockholders. Yet the need of the creditor is to realize his debt. But the maturity of income bonds usually is long. Nor have preferred stocks term at all. It is fanciful to suppose a creditor waiting the twenty or one hundred years to maturity to enjoy his income bond's priority of principal or awaiting the perpetuity mentioned in his company's charter as the term of its existence, to enjoy in distribution the priority of his preferred over the com-

mon stock. Nor is he likely, if he can help it, to linger even until sooner failure of the new enterprise shall have afforded earlier opportunity to assert his priority or preference over the common stock. To realize whatever he may hold, whether bond or preferred stock, the market must be his resort. But in the market price is what he seeks. Prior or preferred though his income bond or stock may be, it helps him little if because of low rate of return or for other reason it brings him less than he would have got for common stock. Value, therefore, and not rank, of his security is the essential. Nor is it material whether his superiority in value be achieved by giving to him ratably more stock of the same rank than is given stockholders or ratably the same amount for a less assessment.

But assuming it were a benefit to the creditor to be assured a priority or preference accorded by a formula, rather than a solid market value under an offer which the Chancellor, who knows the case, shall have declared fair and reasonable, there remains the question how property is to be put behind the income bonds or preferred stock which the formula requires. If an unsecured creditor must have, in securities outranking anything given stockholders, a par amount equal to his debt with interest, is the secured creditor to fare worse as against the unsecured than the unsecured against a stockholder? Yet if the secured creditor is to have a prior lien for his whole debt and interest before an unsecured creditor gets anything, how can there in the usual case be any value to

support bonds or preferred stock for the unsecured creditor as required by the formula? In railroad reorganizations, new securities, since the Transportation Act, can be issued only with the assent of the Interstate Commerce Commission. It has been loath, and rightly so, to permit mortgage bonds or preferred stock to be issued beyond the value of the property or even for its full value. In consequence, unless mortgage creditors have been unfairly dealt with, there often does not remain value of property sufficient to support for unsecured creditors a par value of preferred securities to satisfy the formula. The solution may often have to be to give to unsecured creditors preferred stock if and to the extent it may be available and in addition to give to them and to stockholders who supply new money by taking bonds at a high price, common stock without par value representing hope of the new company's growing prosperity, in which unsecured creditors shall receive a greater ratable share than stockholders.

Appellants sacrifice accuracy for the sake of symmetry of their argument when they assert that the **Boyd** case merely mitigates for railroads and other public utilities a general rule that in reorganizations creditors must be paid in full in cash before stockholders may receive anything. Neither the language of the **Boyd** case nor of the other cases which deal with the doctrine of that case, nor general equitable principles, support the assertion.

The suggestion of appellants can scarcely be serious that it is necessary to substitute a formula for the judicial,

equitable discretion of the Chancellor as to whether a reorganization offer is fair, in order to prevent fairness from degenerating into a mere phrase to be applied according to the individual whim of the Chancellor. Formulas which shall render unnecessary wisdom, knowledge and consciences in Judges have been will-o'-the-wisps of the law, followed only too often in vain and to destruction. Considerations which have led courts for centuries to decline pleas to reduce to a formula the definition of fraud are as valid against making a formula for fairness. The "fixed rule" of the **Boyd** case, that creditors must be better treated than stockholders, courts can administer. But a formula defining in advance for all reorganizations, of all properties, in all conditions, what such treatment must be, they could not. For reorganizations can never be alike. It would be a miracle of coincidence if in any two the value of the failed company's property, its debts, the amount, rank and relative proportion of liens, the money market at the time of reorganization, amount of new money required, and other decisive circumstances were identical. For these reasons each of the questions certified should be answered in the affirmative.

ARGUMENT.

POINT I.

The test of a fair and reasonable offer under the doctrine of the Boyd case is whether the value of the offer made to creditors adequately represents, in the light of all the facts in the case, their proportionate interest in the reorganized property. The character of the securities offered to creditors is immaterial.

(a) **The decided cases are in harmony with this view.**

The contention of the appellants in the Circuit Court of Appeals and in the District Court was, primarily, as stated in the certificate of the Circuit Court of Appeals, that the offer made to creditors was not fair and reasonable, irrespective of the comparative value of the securities offered to creditors and stockholders, because all the securities offered to creditors were not prior in rank to all securities offered to stockholders.

It is clear that all contentions of the appellants have been decided adversely to them by the Circuit Court of Appeals, except the contention based on a suggestion or dictum of this Court in the **Boyd** case, which has been referred to this Court by the Circuit Court of Appeals for determination.

This Court has had before it but three cases, so far as we are advised, involving the rights of unsecured cred-

itors in the reorganization of a corporation by foreclosure and sale. These were

Louisville Trust Company v. Louisville etc. Ry., 174 U. S. 674 (Monon case), decided in 1899;

Northern Pacific Railway v. Boyd, 228 U. S. 482 (Boyd case), decided in 1913, and

Kansas City Southern Ry. Co. v. Guardian Trust Company, 240 U. S. 166 (Guardian Trust case), decided in 1916.

The case of **Pierce v. United States**, 255 U. S. 398, on which the appellants rely, had to do with the enforcement of a judgment obtained by the United States against stockholders to whom the debtor corporation had distributed its property without consideration. No offer to creditors was in any way involved.

The **Monon case**, the **Boyd case** and the **Guardian Trust Company case**, as well as many others, hold that reorganizations carried out by agreements between between bondholders and stockholders are entirely proper, and in most cases essential to substantial justice to all, if stockholders thereby do not secure for themselves an interest in the reorganized property to which unsecured creditors are equitably entitled (Fosdick v. Schall, 99 U. S. 235; Canada Southern Ry. Co. v. Gebhard, 109 U. S. 527; Central Trust Company v. U. S. Rolling Stock Co., 56 Fed. 5; Guaranty Trust Co. v. Missouri Pacific Ry. Co., 238 Fed. 812; Lane v. Equitable Trust Co., 262 Fed. 918 [being same Wabash reorganization before Supreme Court of Michigan

in case of Marshall v. Wabash Railroad, cited by opposing counsel]; St. Louis & San Francisco Ry. Co. v. McElvain, 253 Fed. 123).

This Court never questioned that bondholders are entitled to foreclose their mortgages, and to take to themselves the entire property subject thereto, if such property could not be sold for more than enough to satisfy the mortgage, excluding both unsecured creditors and stockholders. It has held, also, that stockholders may retain an interest if not done at the expense of creditors, and that, if creditors are fairly provided for, they cannot complain.

In none of the cases before this Court had any offer of participation been made to creditors, so that this Court has never had occasion to decide how such an offer must be made, or of what it must consist. Obviously, no general rule can be laid down, since the fairness of an offer to creditors must depend on the facts of each particular case, including the value of the property involved, i. e., to what extent creditors have any interests to be protected, after satisfaction of the secured debt (see discussion in **Guardian Trust Co.** case, referred to at p. 43, infra) and the relative participation of bondholders, creditors and stockholders. This is more fully discussed under point II, infra, p. 35. In the **Boyd** case, however, this Court, although no offer was before it, answered an objection made by counsel for the defendant railway company, that the rule laid down by this Court would require the pay-

ment of unsecured creditors in full, and in cash, and prevent reorganizations, by saying (at page 508):

> "This conclusion does not, as claimed, require the impossible and make it necessary to pay an unsecured creditor in cash as a condition of stockholders retaining an interest in the reorganized company. **His interest can be preserved by the issuance, on equitable terms, of income bonds or preferred stock.**" (Boldface type ours.)

It should be noted that, even if the bold-face type language were a decision of this Court, instead of a suggestion, it would not sustain the contention of the appellants. It does not say, or even imply, that creditors must receive securities of a higher rank than stockholders, **for in the reorganization under consideration in the Boyd case preferred stockholders of the old company received preferred stock in the new company.** (See 228 U. S. 482 at page 489.) It simply means that creditors must receive, in lieu of cash, a fair offer in securities having a real value. To sustain appellants' claim they contend, not only that the suggestion or dictum in the Boyd case was a binding general rule laid down by this Court, but also that it means that in every case, irrespective of the value of the property and of the character or value of securities received by bondholders and stockholders, creditors must receive "income bonds or preferred stock." The logical difficulties which this contention involves will be discussed under (b) below (p. 26).

It must be repeated again that no offer to creditors was before the Court in the **Boyd** case, and that the expression above quoted was merely a suggestion or dictum. This Court has said:

> "It is a maxim not to be disregarded that general expressions in every opinion are to be taken in connection with the case in which those expressions are used. If they go beyond the case they may be respected, but ought not to control the judgment in a subsequent suit when the very point is presented for decision" (Cohens v. Virginia, 6 Wheat. 264, l. c. 398).

Since this Court has never had a specific offer to creditors before it, it has never had occasion to apply to specific cases the principles enunciated in the cases above referred to. The District and Circuit Courts have, however, frequently done so. The Circuit Court of Appeals for the Eighth Circuit, in **Western Union Telegraph Company v. United States and Mexican Trust Company**, 221 Fed. 545, at p. 549, said:

> "Any plan or scheme threatened or executed whereby the holders of the bonds secured by the mortgage and the stockholders secured, or intend or undertake to secure, to the stockholders, by contract, foreclosure sale, or other device, an equal or a greater benefit from the property than is thereby secured to, or offered to and rejected by, the general creditors, is such a breach or threatened breach of trust as entitles any complaining creditor to relief in a court of equity. A purchase through a foreclosure sale, or

otherwise, of the property of an insolvent corporation by a new corporation, pursuant to a plan or scheme of the bondholders and stockholders of the insolvent company, whereby the stockholders thereof derive, by receipt of stock or bonds of the new company, or otherwise, **benefits equal to or greater than** those received by, or openly offered to and rejected by, its general creditors, is fraudulent in law as to the latter, and renders the new corporation and the property it purchased at such sale liable for the claims of such creditors against the old company, at least to the extent of the value of the interest secured by the stockholders of the old company in excess of the value of the interest secured by, or openly offered to and rejected by, the unsecured creditors (Northern Pacific Ry. Co. v. Boyd, 177 Fed. 804, 101 C. C. A. 18; Northern Pacific Ry. Co. v. Boyd, 228 U. S. 482, 502, 504, 33 Sup. Ct. 554, 57 L. Ed. 931; Louisville Trust Co. v. Louisville etc. Ry. Co., 174 U. S. 674, 683, 684, 19 Sup. Ct. 827, 43 L. Ed. 1130; Central Improvement Co. v. Cambria Steel Co., 210 Fed. 696, 701, 702, 127 C. C. A. 184, 189, 190." (Bold-face type ours.)

And the same Court in **Phipps v. C. R. I. & P. Ry. Co.**, 284 Fed. 945, said:

"In support of this contention they cite and the Court has examined Kansas City Southern R. Co. v. Guardian Trust Co. et al., 240 U. S. 166, 36 Sup. Ct. 334, 60 L. Ed. 579; Northern Pacific R. Co. v. Boyd, 228 U. S. 482, 33 Sup. Ct. 554, 57 L. Ed. 931; Texas & Pacific Ry. Co. v. Bloom, 164 U. S. 636, 17 Sup. Ct. 216, 41 L. Ed. 580; Texas & Pacific Ry. Co. v. Johnson, 151 U. S. 81, 14 Sup. Ct. 250, 38 L. Ed. 81; South-

ern Pacific Ry. Co. v. Bogert, 250 U. S. 483, 39 Supt. Ct. 533, 63 L. Ed. 1099. But the opinions and decisions in those cases do not consider or rule the question in this case, because in none of them had the Court, in the decree assailed, considered, adjudged, secured or offered to the complainant his or its fair and just share of the property of the insolvent corporation it was administering and distributing, while in the case in hand the courts by their decrees carefully adjudged, secured, and still secure to Mr. Phipps his equitable share of the property which the Court administered and distributed.

"The vice which rendered the foreclosure, judicial sale and delivery of the property to the reorganized corporation voidable by unsecured creditors in the Boyd case, 177 Fed. 804, 101 C. C. A. 18, Id., 228 U. S. 482, 502, 504, 33 Sup. Ct. 554, 57 L. Ed. 931, and in the Kansas City Southern Ry. Co. case, 240 U. S. 166, 36 Sup. Ct. 334, 60 L. Ed. 579, was not the lack of judicial sales of the property under the decrees, but the fact that under the plans of reorganization and by the decrees in those cases the stockholders of the insolvent corporations were given for their stock beneficial interests in the reorganized companies by the way of stocks, bonds, or other securities, while the unsecured creditors of the insolvent companies were given nothing. That vice does not inhere in the plan of reorganization or in the decrees in the case at bar. That plan and those decrees secured to Mr. Phipps and to the other unsecured creditors, beneficial interests in the reorganized company **of much greater proportionate value** than those thereby secured to the stockholders of the insolvent company."

* * * * * * * *

"An analogous question arose in the foreclosure of mortgages upon the property of railroad companies after the Supreme Court had held in the Boyd case and the Kansas City Southern Railway Company case that judicial sales under decrees of foreclosure of such mortgages pursuant to the plans of reorganization which did not assure to unsecured creditors interests in the property of the reorganized corporations **more beneficial proportionately** than those secured to the stockholders were voidable by such creditors." (Bold-face type throughout ours.)

In **Mountain States Power Co. v. A. L. Jordan Lumber Co.**, 293 Fed. 502, the Circuit Court of Appeals for the Ninth Circuit said:

"The next question is, was adequate and equitable provision made to preserve the interest of the lumber company under the reorganization? There was no offer or tender of income bonds or preferred stock, as suggested in the Northern Pacific case (**Boyd** case). Of course, the method there suggested is not exclusive * * *"

and then went on to hold, that, in the light of the facts as to the value of the property involved, the offer under consideration was not a fair and reasonable one.

See also **Howard v. Maxwell Motor Company**, 269 Fed. 292 (affirmed 275 Fed. 53, by Court of Appeals for Second Circuit), in which an offer to creditors consisting of preferred and common stock, as in the case at bar, was approved.

See also **P. R. Walsh Tie & Timber Co. v. Missouri Pa-**

cific Railway Company, 280 Fed. 38 (Circuit Court of Appeals for Eighth Circuit).

The opinion of the trial court (Judge Sanborn, senior Circuit Judge), approving the offer to unsecured creditors, in the case at bar, reads as follows:

> "This Court has said and written so much in the last six years concerning the relative rights and remedies of the stockholders and unsecured creditors of an insolvent railroad company under a plan of reorganization of such company similar to that under consideration in this case, and concerning the fairness, justice and timeliness of offers to unsecured creditors in the benefits of such reorganized corporations through stock, bonds or otherwise, that it would be useless in this case to do more than to say that the reasons for the conclusion the Court now has reached in this case are stated in its oral opinion delivered in this court about August 13, 1916, in North American Company v. St. Louis & San Francisco Railroad Company, No. 4174, Consolidated Cause, final; in its opinion in Guaranty Trust Company v. Missouri Pacific Railway Company, 238 Fed. 812 and in its opinion in St. Louis-San Francisco Railway Company v. McElvain, 253 Fed. 123, and in the opinions of the Circuit Court of Appeals of this circuit in Phipps et al. v. Chicago, Rock Island & Pacific Ry. Co., filed October 9, 1922, and in P. R. Walsh Tie & Timber Company v. Missouri Pacific Railway Company, 280 Fed. 38, 42-44.
>
> "In comparing the offer in this case with those made in the cases cited, this radical difference in the basis of the offer should not be overlooked. The evidence in this case is that the value of an unsecured

claim of $1,000 against the old insolvent company, based on the present market value of the stock offered to the owner of such a claim pursuant to the decree, is about $235.84, or about 23.6 per cent of the amount of the claim. But the amount of the claim of which this offer is 23.6 per cent is the amount of the face of the claim in September, 1915, when this Court took possession of the property of the insolvent company by its Receiver, plus interest on that amount at 6 per cent per annum from that time to January 1, 1922. The interest during this time, at 6 per cent per annum, amounts to above 43 per cent of the amount of the claim in September, 1915, so that while the market value of the securities offered an unsecured creditor is about 23.6 per cent of the amount of his claim in April, 1916, plus interest on that claim at 6 per cent from April, 1916, to January 1, 1922, its market value is more than 31 per cent of the amount of the claim in September, 1915, when the Court took possession of the property.

"When a court appoints a receiver and takes possession of the property of an insolvent corporation to operate it and distribute it or its proceeds to its creditors and stockholders it holds it in trust subject to prior liens for the unsecured creditors and stockholders at that time. Stockholders ordinarily receive no dividends during a receivership, and the established rule of practice and convenience is to allow the claims of unsecured creditors at their face value plus interest to the date of the appointment of the receiver, and not later. The amounts of the claims of the unsecured creditors in the St. Louis & San Francisco Railroad reorganization and in the Missouri Pacific Railroad reorganization were fixed and allowed and the securities of the new companies

were distributed to them upon that basis, and it is probable that this was the basis used in the reorganization of the Chicago, Rock Island & Pacific Railroad Company.

"When this fact is taken into consideration, together with all the other facts proved in this case and the facts disclosed in the opinions in the cases cited, the offer to the unsecured creditors in this case in comparison with the offer to the stockholders is much more favorable to the former than were the offers made to the unsecured creditors in the cases cited. And, upon consideration of all the facts and arguments in this case, and for the reasons stated in the opinions in the cases cited, the Court has concluded that the offer to the unsecured creditors in this case is fair, just, equitable and timely, and that it should be approved" (Tr. of Rec., p. 493).

The opinion of Judge Sanborn in **North American Company v. St. Louis & San Francisco Railroad Company**, referred to in the above opinion is, for convenience of this Court, printed as Appendix A to this brief.

We know of no case, either in the federal or state courts, in which an offer to creditors has been held unfair because of the **character** or **relative rank** of securities offered creditors or stockholders. The appellants cite **Wabash Railway Co. v. Marshall**, 224 Mich. 593, 195 N. W. 134 (Supreme Court of Michigan, 1923), as an authority in their favor. In this case, however, the Court allowed the creditor to recover against the reorganized company, not because the offer to creditors consisted of preferred and common stock, but because (a) the stock

had not been authorized by the Michigan Railroad Commission and (b) the offer was insufficient in amount in view of the value of the property.

In every decided case fairness or unfairness has been determined on the basis of the **relative value** of the securities offered, and in consideration of the value of the property involved and all other pertinent facts. This, we submit, is the only true test.

(b) **There is no logical basis for the contention that the character of the securities offered to creditors is the test of a fair offer.**

The test established by the decided cases above referred to is the only logical test of a fair offer to creditors. Obviously, in a reorganization, bondholders, unsecured creditors and stockholders desire to get back, as nearly as possible, the amount of their investment. They are interested in their relative rank in the new company resulting from the reorganization only to the extent that a higher rank represents greater value. And this is preeminently true of an unsecured creditor, who is an involuntary investor. The unsecured creditor does not care whether he receives preferred stock or common stock, so long as the value of what he receives is the same. If the appellants in this case were asked whether they would prefer to receive cash in full, or preferred stock to a par amount equal to their claims, can anyone doubt they would choose the cash? In other words, the attempt of the appellants to insist on an offer of preferred stock or income bonds is

merely an attempt to secure a greater amount for their claims in money or its equivalent—an attempt to review, under guise of a claimed principle of law, the finding of the District Court, in which the Circuit Court of Appeals apparently concurs, that they have been offered all that could reasonably be expected under the existing circumstances.

The true principle of the **Boyd** case is that, to the extent that the fair value of the mortgaged property exceeds the secured debt, unsecured creditors must be offered a right to participate in such excess ahead of stockholders by making them an offer of participation of a fair **comparative value.** Any other principle overlooks the substance of the situation and deals only with technicalities.

The application of the principle contended for by the appellants would in this case and in other reorganization cases produce absurd results. In this case the certificate of the Circuit Court of Appeals shows that certain classes of bonds received in the reorganization some preferred stock, and/or some common stock. The certificate also shows that old preferred and common stockholders were entitled to receive prior lien mortgage bonds, adjustment mortgage bonds and common stock in the amounts stated on payment of assessments of $20 and $25, respectively. Stockholders could not receive any securities unless they paid the assessments and purchased the group of securities offered to them. On the appellants' theory that unsecured creditors must receive securities of higher rank

than any securities sold to stockholders, it must be equally true that secured creditors must receive securities of higher rank than those offered to unsecured creditors. Obviously, since the secured creditors in some cases received common stock and the stockholders were allowed to purchase bonds, no offer to unsecured creditors could be made which would comply with the appellants' theory. In other words, no reorganization in which bondholders accept common stock could be consummated on the appellants' theory, unless unsecured creditors were paid in full. Yet it is most desirable in many cases to have bondholders accept stock for part of their claims.

The appellants have consistently disregarded the fact that the offer in the reorganization to certain classes of bondholders was only a very little better than the offer made to unsecured creditors, that is to say, they disregard the fact that the unsecured creditors would have received nothing unless the bondholders were willing to make concessions, and that the fairness of the offer to creditors depends not only on the amount offered to stockholders, but also on the amount accepted by bondholders.

What the secured creditors having liens of various ranks and priorities give up in order to bring about reorganizations in the interest of all concerned, as well as what the old stockholders are assessed, manifestly is for the benefit of and not in anywise at the expense of unsecured creditors. All the cases recognize the fact that except for the voluntary surrender by the bondholders of parts of their legal rights and the voluntary payment of assess-

ments on the stockholders, the unsecured creditors as a rule would receive nothing.

In Fletcher, Cyclopedia Corporations, Volume 7, Section 4950, that author says:

> "If the rights secured to the stockholders are at the expense of the bondholders and not of the unsecured creditors the latter cannot complain."

Practically all of the cases recognize that fresh or new money is essential to any plan of reorganization and as a general rule this money can only be raised through an assessment upon the old stockholders.

In the case of Walsh Tie and Timber Company v. Missouri Pacific Railway Company, 280 Fed. 38, the Circuit Court of Appeals for the Eighth Circuit said:

> "The acceptance of the plan by the holders of mortgage bonds in excess of $60,000,000, superior in right to the claims of general creditors, and the surrender of those bonds for convertible 5 per cent preferred stock, par for par, is a powerful refutation of the contention that general creditors were not fairly and equitably treated. The Court gave full and careful consideration to the reorganization plan and appellants' objections, and in approving the former and overruling the latter said:
>
> > " 'The general creditors have been treated very, very fairly indeed.' "

The assessment on the old stockholders and the requirement that they purchase certain bonds at par regardless

of their market value was a burden rather than a benefit and was the condition on which the stockholders were allowed to retain an interest in the new company (Guaranty Trust Co. of New York v. Missouri Pacific R. R. Co., 238 Fed. 812, at page 818).

In Volume 7, Fletcher, Cyclopedia Corporations, Section 4950, it is said:

> "An assessment upon the common stock may take the form of requiring stockholders to pay in cash a certain per cent of the par of their holdings for which they are to receive new bonds at par carrying a low rate of interest and being inferior liens, since in such a case it is doubtful whether the bonds will ever be worth par, and, hence, it operates as an assessment upon the common stock to the amount of the discount."

The appellants' theory also completely disregards the possibility that an offer made in preferred stock or income bonds to unsecured creditors might well be of less value than an offer made in common stock. It would have been entirely possible in this reorganization to offer to unsecured creditors income bonds or preferred stock bearing a low rate of interest or dividend which would have had a value less than the value of the securities which they were offered. This would have been a strict compliance with the suggestion or dictum in the **Boyd** case and yet the appellants doubtless would not have been any better satisfied with that offer than they were with the offer which they received. Obviously, however, if the

offer had been in that form, the Circuit Court of Appeals, since its only hesitation arose from the suggestion or dictum in the **Boyd** case, would have held it a fair and reasonable offer. If the suggestion or dictum of the **Boyd** case should now be changed into a fixed rule of law, reorganizations might well become substantially impossible. We submit, however, it is not a dictum of this Court, but only a suggestion, and not an exclusive one. This is particularly true now in respect of railroad reorganizations, for, since the passage of the Transportation Act of 1920, the Interstate Commerce Commission passes not only on the aggregate amount of securities which may be issued in a railroad reorganization, but also on the character of such securities, and requires that the amount of bonds and preferred stock issued should be well within the value of the properties and that the interest or dividends thereon should be within the probable earning power of the properties. If creditors must in every case be paid in cash or given preferred stock or income bonds, either reorganizations will become impossible or bondholders will be forced to make disproportionate sacrifices. In other words, unsecured creditors will be preferred over secured creditors, and the whole theory of the **Boyd** case will be upset.

It thus seems clear that any measure of a fair offer based on the character of securities offered is illogical and disregards the substantial questions involved. Value of securities and of property is and must be the true test.

The certificate shows that the appellants originally intervened in these reorganization proceedings for the purpose of compelling the new company to assume cer-

tain terminal contracts which they claimed were entitled to priority over the foreclosed mortgages and were covenants running with the railroad. When these contentions were not sustained by the Circuit Court of Appeals and this Court refused to review the decision of the Circuit Court of Appeals, the appellants attempted to secure substantially the same result by a claim that no fair offer could be made to them, except an offer to assume the terminal contracts. This was simply an attempt to reargue in another form a question already *res adjudicata*. The appellants are now attempting to bolster up this contention by an endeavor to get more money for whatever claims they may have against the old company because of the failure of the new company to adopt the Terminal contracts. That is really all that is involved in this case.

It may be mentioned in passing that the appellants devote some space in their brief to a discussion of the assessment on the stockholders, reaching the conclusion that the stockholders practically received their new common stock free of charge, since they were given bonds to a full principal amount equal to the amount of cash they were required to pay, and thus put into the property nothing which they did not immediately take back for themselves. The stockholders were not given anything. They not only surrendered their old stocks, preferred and common, as part consideration for new common, but were required to pay assessments for which they were entitled to receive certain bonds at par. We do not argue that this case is taken out of the principle of the **Boyd**

case, because securities were sold to the stockholders and nothing given to them. We do argue, however, that, as pointed out in all the cases, the new or fresh money necessary in all reorganizations can be raised as a rule only from the stockholders and cheaper from them than from anyone else; that if this money is not so raised there can be no reorganizations and the creditors will receive little or nothing; that the amount of securities which the stockholders were required to take at par must be calculated so as to give only such reasonable opportunity of profit as will induce stockholders to put in the necessary new money—it being generally true that the bonds which the stockholders receive have a value substantially less than their face amount. The stockholders actually contribute money to the property which they cannot get back until the maturity of their bonds and which in the meantime is earning a return for the benefit of all security holders, including unsecured creditors who accept the offer.

(c) **The Effect of an Assessment on Creditors.**

We have pointed out above that since the offer to unsecured creditors in this reorganization was made in the alternative, the answer to the third question of the Circuit Court of Appeals, in so far as it involves the question of payment by unsecured creditors, is immaterial. It was not the **only** offer. The creditors had a choice of offers. We believe, however, that an offer to unsecured creditors in the form of an option to purchase securities of the new company might well be under proper circumstances a fair and reasonable offer, when, as here, it is

admitted to be better than the corresponding offer to stockholders.

One of the reasons, we repeat, why the courts recognize the propriety of permitting stockholders to participate in a reorganization is the necessity of raising new money for the reorganized property by assessment on stockholders. The courts also recognize that the secured creditors may, if they so desire and if the property is not worth more than the amount of secured debt, take all the property to themselves and exclude both unsecured creditors and stockholders. If, therefore, in a reorganization the property reorganized is worth no more or little more than the amount of secured debt thereon, so that unsecured creditors could not hope to receive anything except through a reorganization plan, and if the amount of new money required is so large that it is impracticable to raise it all from stockholders, unsecured creditors should not be heard to object if they, as well as the stockholders, are given an opportunity to subscribe for new securities of the reorganized company, but on better terms than stockholders may do so. It would, of course, be essential that if the value of the securities sold to stockholders is in excess of the amount they are required to pay therefor so that stockholders reserve some interest in the new company, the securities sold to creditors should be worth a greater amount in excess of the price paid therefor, the amount of the differential in favor of creditors as against stockholders depending on the relation of the value of the mortgaged property to the se-

cured debt. In the instant case, not only was there a differential in favor of creditors, because of the lower price at which the securities were offered, but the creditor was also favored by the fact that the amount of new securities which he was allowed to purchase was based on interest on his claim as well as on principal. If the opportunity given to stockholders to purchase certain securities by way of assessment was of any value (i. e., if the stockholders received anything) the option given creditors to purchase the same securities for substantially less was more valuable. The Certificate of the Circuit Court of Appeals gives no facts as to the value of the reorganized property in this case or as to the amount of the secured debt thereon, so that there is not and cannot be before this Court the question whether the specific offer (known as offer B) made to unsecured creditors in this case would have been a fair and reasonable offer if there had been no alternative offer.

POINT II.

There is no basis in the decisions or in the principles of equity for the contention that this Court should establish a fixed formula by which all cases of this nature can be decided.

The appellants, in their brief in this court, have practically abandoned any attempt to support the literal acceptance of the suggestion or dictum in the **Boyd** case on a practical and logical basis, and devote the greater part

of their brief to a plea that this Court should establish a formula by which all offers to creditors may be tested, such formula to be "preferred stock or income bonds." For obvious reasons they prefer to call this suggested rule-of-thumb a "fixed principle" rather than a formula. The contention is based on a misapplication of the principles of equity and a misconception of the **Boyd** case and its relation to the general body of law.

The **Boyd** case decided one point and only one. That point was that in a reorganization carried out by foreclosure of mortgages in pursuance of a reorganization plan in which stockholders participate, a creditor may follow into the hands of the new corporation the property of his former debtor unless he is offered the opportunity to participate in the reorganization on equitable terms. This is a general equitable exception to the common legal rule that a mortgagee may purchase property at foreclosure sale and may thereafter dispose of the property so purchased in such manner as he wishes, cutting off junior liens and interests. It is not derived from the rule that a mortgagor may not buy in at his own mortgage sale and cut off intervening rights, but is a separate and distinct equitable principle, an example of equity's power to make exceptions to legal rules in order to secure equity. It is based on the magnitude of large corporate enterprises and on the fact that a large corporate property cannot under normal circumstances be expected to bring at foreclosure sale a price commensurate with its value, because

the amount required to be paid is so large that ordinarily no one but the old security holders can bid at the sale.

There is no shadow of intimation in the cases to support the contention of the appellants that the suggestion of the **Boyd** case requiring a fair offer is a special exception applicable only in railroad cases to a general rule that creditors must be paid in full in cash if stockholders are to be given anything at all on reorganization. In the **Boyd** case itself no offer had been made, and none had been made in the **Monon** case or the **Guardian Trust Company** case, nor has this Court had occasion to pass on any case in which an offer had been made. The District and Circuit Courts have been unanimous in treating the rule as one single rule rather than a rule and an exception.

Still less is there any reason to limit the application of the so-called "exception" to railroad reorganizations. The language of this Court in the Boyd case refers in broad terms to all reorganizations. It is true that all of the cases before this Court and most of the cases in which these questions have arisen have been cases of railroad reorganization, because until recently there were few industrial reorganizations of sufficient magniture to raise similar questions. In **Howard v. Maxwell Motor Company,** 269 Fed. 292, however, the Court treated the entire rule as applicable to an industrial reorganization, and in **Mountain States Power Company v. Jordan Lumber Company,** 293 Fed. 502, to a public utility reorganization. Nowhere in the cases is there any indication that a "fair

and reasonable" offer to creditors in an industrial reorganization will not protect the new company as fully as in a railroad reorganization.

The appellants desire to limit to railroad reorganizations at least that portion of the doctrine which they treat as the exception (i. e., the right to cut off a creditor by making him a fair offer of participation), because they wish to analogize this part of the doctrine to the cases of so-called "six months claims" and displacement of liens by receiver's certificates in which they claim fixed rules have been laid down, and to argue that there must be a formula by which the rights of creditors may be measured. In support of their contention for a formula they cite the language of Mr. Justice Lamar in the **Boyd** case, to the effect that the right of a creditor to go against the new company is not dependent upon the value of the property of the old company, but must be determined by an absolute rule. They also cite various statements by eminent jurists and text writers to the effect that equity decides cases on fixed principles. From these statements they argue that the question of the rights of creditors in railroad reorganizations must be reduced to a formula so as to avoid the danger of leaving each case to be decided in the sound judicial discretion of the Chancellor. This argument of the appellants disregards the great distinction between a fixed principle and a formula. Neither the statements quoted in their brief nor the language of Mr. Justice Lamar above referred to constitute any authority for the adoption of a formula.

The courts have never fixed a rigid rule as to what claims may be preferred over mortgage indebtedness.

In Tardy's Smith on Receivers, Volume I, at page 1144, that author states:

> "An attempt to state a general rule sufficiently definite as to the class of creditors that would be so preferred and the fund from which they would be paid to furnish an accurate guide for saying in advance what the decision of a court would be in any given case would certainly not be without difficulty. Perhaps the best that can be said about this point is, as was said in the first case (Fosdick v. Schall, 99 U. S. 235), in which the United States Supreme Court entered an opinion on the subject, that: 'No fixed and inflexible rule can be laid down for the government of courts in all cases. Each case will necessarily have its own peculiarities which must to a greater or less extent influence the Court when he comes to act.' "

In Volume 33, Cyclopedia of Law and Procedure, at page 536, it is said:

> "In respect to debts incurred before a receiver was appointed, in order that they may be entitled to priority within the meaning of the above rule, they must have been incurred within a reasonable time before the receiver was appointed and left unpaid because of the sudden action of the Court in making such appointment. The determination of this period is ordinarily within the sound discretion of the Court having jurisdiction of the accounts, and has usually been fixed at six months before the appointment of the receiver, although as to such debts there is no arbi-

trary six months' rule, and the equities of the case may be such that a claim will be allowed preference if incurred within a year, or even for a longer period, as where the services are rendered or supplies furnished under a continuous contract, or where the delay in enforcing payment was not caused by the creditor."

One reason that in the earlier cases six months was generally fixed as approximating the time in which preference claims must accrue was, that there is usually an interval of six months between the dates when installments of interest upon bonds fall due (Westinghouse Air Brake Co. v. Kansas City Southern Railway Co., 137 Fed. 26).

In 22 Ruling Case Law, page 1137, it is said:

"But notwithstanding what is said in some cases, concerning the time within which a claim must have been contracted, before the appointment of the receiver, and within which, if it is a preferred claim, it may be enforced, there is no fixed rule upon the subject. The allowance of preferred claims, in equity, against the property of a railway company in the hands of a receiver does not depend upon any fixed or arbitrary rule as to the time when the debts were contracted; further than that, they must have been contracted within a reasonable time before the appointment of the receiver, such reasonable time depending upon the circumstances of each particular case."

The following are some of the cases in which preference has been allowed to claims older than six months:

Southern Ry. Co. v. Carnegie Steel Co., 176 U. S. 257, 44 L. Ed. 458, 20 Sup. Ct. 347, 8 to 11 months;

Hale v. Frost, 99 U. S. 389, 25 L. Ed. 419, 33 months;

Burnham v. Bowen, 111 U. S. 776, 28 L. Ed. 596, 4 Sup. Ct. 675, 11 months;

Virginia & A. etc. Co. v. Central R. R. etc. Co., 170 U. S. 355, 42 L. Ed. 1068, 18 Sup. Ct. 657, 8 months;

Central Trust Co. v. St. Louis etc. Ry. Co., 41 Fed. 551, 1 year;

Farmers' Loan & T. Co. v. Kansas City etc. Ry. Co., 53 Fed. 182, 18 months.

So that it is clear that opposing counsel gain nothing by analogy or otherwise from their argument with respect to such matters, as no fixed and arbitrary rules have been prescribed. On the contrary, certain general principles have been applied to the facts of each case. All the analogies are against appellants. Nor do opposing counsel gain anything by their reference to the decisions of the courts with respect to the issuance of receiver's certificates. The courts have not laid down any general or inflexible rules with respect to the purposes for which receiver's certificates may be issued, or in just what cases they may be given priority over mortgage or other indebtedness, but every case has been decided on its peculiar facts by the application of general equitable princi-

ples rather than fixed and arbitrary rules. In 23 Ruling Case Law, p. 91, it is said, "questions of priority are not governed by any fixed and inflexible rule," and the same is true with respect to purposes for which they may be issued (Id. p. 95). Here again the analogies are against appellants.

The **Boyd** case itself must be taken in its setting. Somewhat over-simplified and too symmetrical is the scheme of appellants' argument in explaining it as merely a reminder to the lower courts of the principle decided in Howard v. The Railroad Company. When this Court extended the principle of the **Howard** and **Monon** cases to the facts of the **Boyd** case it recognized the gravity of the step. This appears not only from the vigor and weight of the dissenting minority, but perhaps even more clearly from the degree in which the majority were at pains by suggestion, illustration and dictum unnecessary to the decision itself to indicate how narrow its limits were and how wide a field it left untouched. The decision fixed indeed the general principle that even where there is foreclosure creditors may not be ignored and frozen out **without an offer** while stockholders are recognized. But this Court did not attempt to decide future cases in which there might be an offer. Yet appellants attempt to erect the illustration given by the Court

to allay the fears of counsel regarding future reorganizations into a fixed formula to be applied to all cases, mechanically and regardless of the facts. Clearly it could not have been the intention of the Court to legislate for future cases.

In the **Boyd** case no contention apparently was made that the value of the property after providing for the mortgaged debt was insufficient to pay the unmortgaged debt and accordingly this Court did not decide that the creditor's right to go against the new company was independent of the value of the property. Mr. Justice Lurton, in the dissenting opinion in the **Boyd** case, concurred in by three other Justices, clearly stated the principle by which the creditor's rights should be measured, when he said at page 511:

> "That corporate property must be applied to corporate debts before stockholders can participate, is plain. But I think every case should stand upon its own facts, and the remedy be shaped to do justice and equity in the particular case, and not tried out by any hard and fast rule such as indicated when this Court says that the invalidity of a judicial sale must turn upon the character of the reorganization agreement and is not affected by actual consequences to creditors."

In the **Guardian Trust Company** case this Court specifically announced the principle that creditors' rights depend upon the value of the property. At page 176 of

the opinion in that case this Court, among other things, said:

> "As the claim of the trust company was put by the Court of Appeals upon the equitable right of creditors to be preferred to stockholders against the property of a debtor corporation, it is essential to inquire whether the appellant received any such property, that is, whether it got by the foreclosure more than enough to satisfy the mortgage which was a paramount lien. * * * Therefore, the $4,750,000 of that stock given for the Belt Company's stock was worth at least $475,000.00 and probably more, but the value of this stock depended on the value of the Belt Company's property above the mortgage."

Obviously, this is the only equitable principle since there is no reason why a creditor should be entitled to get more as a result of a reorganization than he would have gotten if there had been no reorganization. A rule which permits the creditor to recover from the new company, irrespective of the value of the property turned over to it, in effect imposes punitive damages on the stockholders, although the **Boyd** case clearly states that its decision is not based on any fraud or illegality or evil doing of any sort on the part of the reorganizers. Every case which has been decided since the **Boyd** case has by its language restricted the creditor's rights to the value of the property, in other words, has simply preserved his rights without adding to them. This point was expressly decided by the Court of Appeals for the Ninth Circuit in

Mountain States Power Company v. Jordan Lumber Company, supra.

Of course, the value of the property in this case is not in issue in answering the questions certified by the Circuit Court of Appeals. The foregoing, however, illustrates not only that there is no formula, as asserted by the appellants, for determining the extent of a creditor's rights, but that there could be no such formula as the appellants suggest without violation of all equitable principles. Similarly, there can be no formula to determine what offer of participation must be made to a creditor. Admittedly, equity acts in accordance with fixed principles, the fixed principle in this case being that a creditor cannot be cut off by foreclosure proceedings in which stockholders are interested unless he is given an equitable participation, but to hamper the workings of equity by a formula is entirely contrary to all principles on which equitable doctrines have developed.

The great purpose of equity is to mitigate the harshness of legal rules and to substitute therefor a flexible body of jurisprudence whose decrees can be molded to meet the exigencies of the situation presented, that is, as Mr. Justice Lurton said in the **Boyd** case, "shaped to do justice and equity in the particular case." Every attempt to codify into strict rules the principles of equity jurisprudence defeats at the outset the purpose desired to be achieved, since no one can draw a formula which will meet all situations which may arise.

Counsel for appellants (pages 41, 50 and 51) quote excerpts from a monograph on reorganization by Mr. Paul D. Cravath, a lawyer of preeminent standing and an acknowledged authority on matters pertaining to corporate reorganizations. We respectfully submit, however, that none of the excerpts in any way support the contentions of opposing counsel nor in any of the excerpts is any such rule announced as that contended for by them. In all fairness, we think it is but proper to state the fact, which will not be denied by opposing counsel, that Mr. Cravath's firm were counsel for the Reorganization Managers in the instant case and approved the offer to unsecured creditors.

Counsel for appellants have gone outside of the substantive and ultimate facts as set forth in the certificate in their discussion of the value of the securities. They even ask this Court to take judicial notice of the current market prices of some of them, although at page 58 they admit the certificate does not state the market prices of securities at any time and that they would probably fluctuate widely from one date to another and that comparisons would differ according to the dates selected for comparison. The questions as certified show upon their face that the court below was and is of the opinion that on the facts the offer was and is fair and reasonable. No question with respect to the value of the securities was certified. Only three questions of **law** were certified. The whole case was not and could not be certified.

The appellants are asking this Court to lay down as an invariable formula that creditors must in every reorgani-

zation in which stockholders participate be given preferred stock or income bonds. A moment's reflection will show the impracticability of any such fixed rule. Suppose, for example, the corporation being reorganized is in such bad condition that bondholders must consent to take preferred stock or common stock, as indeed some bondholders did for part of their claims in the present case. Must unsecured creditors still receive preferred stock or income bonds? Moreover, if there is to be a formula, should it not be a complete formula, that is, should not this Court lay down a rule fixing the amount of preferred stock or income bonds to be given for every $100.00 of the creditors' claim, and fixing the rate of interest or dividends which should be borne by the preferred stock or income bonds to be offered? There is no reason why the character of the security should be specified and not the terms on which it is to be issued. Obviously, many reorganizations will be rendered impossible if the reorganizers start out with the requirement that unsecured creditors must receive a specified amount of preferred stock or income bonds bearing a specified rate of interest or dividends. This is especially true in a railroad reorganization where the Interstate Commerce Commission must approve the issue of the new securities. If any such fixed rule is to be established, either mortgage bondholders would have to cut down the amount of securities which they would receive, thus preferring unsecured creditors over secured creditors, or it would be impossible to raise the necessary money by assessment on the stockholders,

which this Court has recognized as a customary and proper method of raising the new money necessary in a reorganization. Moreover, if a creditor is to be entitled to recognition of his full claim, irrespective of the value of the property in question, any such formula would in many cases give an unsecured creditor an inequitable preference by giving him a participation much greater than that to which he is entitled. Equity regards the substance and not the form, and will not, by laying down a formula, substitute for a real determination of the equities of a situation, an inflexible and procrustean judicial measuring rod which, though easy to apply, defeats the very purpose for which it is made.

The appellants contend not only that there should be a formula, but that the formula should specify preferred stock or income bonds, and require that creditors in all cases be given securities prior in rank to any securities offered or sold to stockholders. They justify this claim by saying that a creditor has a right to have securities which, although not bound to be paid at all, must in any event be paid before the stockholder receives anything.

This contention may sound well in theory, but has no basis in fact. It is not even justified by the suggestion or dictum in the **Boyd** case, for in the **Boyd** case preferred stockholders were given new preferred stock, and a literal compliance with the suggestion or dictum would not have given creditors any assurance that they would receive their money before stockholders received anything.

The actual value of an offer made to creditors depends, in fact, not on the prior rank of the securities which they receive, but on the value of such securities. The creditors do not expect to receive money for their securities by having them paid off. Income bonds may mature fifty or one hundred years after their date of issue, and preferred stock will never be paid off by the company unless it is redeemed. The actual way in which creditors receive their money is through the value of their securities in the market. Income bonds may well be worth less than preferred stock and preferred stock may well be worth less than common stock. It all depends on the interest or dividend rate paid on the bonds and stock, the relative rights and disabilities of preferred and common stock and on the success of the company's operations. Any formula based on priority in rank disregards substance in favor of form.

All this shows that any attempt to lay down a formula is impossible, and that each case must be decided on all its own facts, taking into account the value of the property and the value of the new securities offered. The appellants foresee direful results if these matters are left in each case to the sound judicial discretion of the Chancellor, but the questions are, as above pointed out, questions of fact and of equity, not of law, and can only be properly decided by the Chancellor familiar with all the facts. If the Chancellor decides them improperly, there is always the right of appeal to the Circuit Court of Appeals, and

the right to a review by this Court if this Court will grant certiorari.

* * * * * * *

The appellants have devoted some space in their brief to a discussion of the effect of the allowance of interest on the fairness of the offer made to unsecured creditors. This question goes only to the fairness of the offer in fact and has no bearing whatsoever on the answers to the questions certified to this Court. We, however, believe that the appellants have misconceived the law on this point.

It clearly appears from the certificate that in all cases the par amount of new securities offered (taking the non-par value stock at $100 per share) plus the cash offered, if any, equaled and in no case exceeded the principal amount of the old outstanding securities in respect of which the offer was made, plus unpaid interest up to January 1, 1922; that the offer to unsecured creditors included interest up to the same date, whereas the Receiver was appointed and took possession of the property on September 27, 1915, and that in all cases new prior lien bonds and adjustment bonds, whether offered to secured creditors, unsecured creditors or stockholders, also bore interest from the same date—January 1, 1922. In this way the unsecured creditors were placed on a plane of equality with secured creditors and thereby further preferred, not only as against secured creditors, but as against old stockholders.

It also appears from the certificate that in all cases new Prior Lien bonds and new Adjustment bonds, whether offered to secured creditors, unsecured creditors or stockholders, also bore interest from January 1, 1922.

In the brief of appellant it is claimed that it is well settled that as against the stockholder the creditor is entitled to the payment of his claim in full with interest. No cases are cited to this effect, but a part of Section 598 (p. 1678), Vol. II, Tardy's Smith on Receivers, is quoted and relied upon as establishing the contention made. Neither that part of the section quoted nor the cases cited by this author support their contention. It is true that in some receivership cases where there were sufficient funds to do so interest has been allowed on some classes of claims, such as supply claims.

In the part of the section quoted it is specifically stated:

> "All creditors are entitled to be paid in full with interest to the time of payment and will be so paid **'if the funds are sufficient.'** "

This same author, further along in the same section, states:

> "As against one another, however, interest is not allowed to members of a class if the class fund is not sufficient to allow interest to all; thus general unsecured creditors, whether their claims bear interest by contract or simply by way of damage for delay in payment, **are not allowed interest in case of in-**

solvency. It is with reference to this last class of creditors that the rule is usually stated to be the general rule."

From the certificate it appears that the properties were sold under final decree, and it does not appear that there were sufficient funds to pay claims of any class, much less unsecured creditors, in full. On the contrary, all classes were offered new securities. Only with respect to five issues out of eighteen of securities was cash offered in part. The old company was hopelessly insolvent.

In Volume I of Clark on the Law of Receivers, Section 867, the rule is stated thus:

> "The general rule is that interest is not allowed after property of the insolvent is in custodia legis. This rule is not based on loss of interest-bearing quality, but it is a necessary and enforced rule incident to equality of distribution between creditors of assets, which in most cases are insufficient to pay all debts in full. Supply creditors to a railway who are preferred, and the fund for their payment is sufficient to pay them in full, may be allowed interest on their claims after the appointment. Lien claimants are generally entitled to interest.
>
> "After property of an insolvent passes into the hands of a receiver, or of an assignee in insolvency, interest is not allowed on the claims against the funds. The delay in distribution is the act of the law; it is a necessary incident to the settlement of the estates."

That the general rule is as we contend for it, and as stated by Judge Sanborn in his opinion (supra, p. 23),

as well as in the above authorities, is well settled by this Court (Thomas v. Western Car Company, 149 U. S. 95; American Iron & Steel Mfg. Co. v. Seaboard Air Line Ry. Co., 233 U. S. 261).

In Thomas v. Western Car Company, supra, this Court said:

> "As a general rule, after property of an insolvent passes into the hands of a receiver or of an assignee in insolvency, interest is not allowed on the claims against the funds. The delay in distribution is the act of the law; it is a necessary incident to the settlement of the estate (Williams v. American Bank, 4 Met. 317, 323; Thomas v. Minot, 10 Gray 263). We see no reason in departing from this rule in a case like the present, where such a claim would be paid out of moneys that fall far short of paying the mortgage debt."

In American Iron & Steel Mfg. Co. v. Railroad, supra, this Court said it is "not because the claims had lost their interest-bearing quality during that period, but it is a necessary and enforced rule of distribution due to the fact that in case of receiverships **the assets are generally insufficient to pay debts in full.**" * * * "For that and like reasons **in case funds are not sufficient to pay claims of equal dignity, the distribution is made only on the basis of the principal of the debt.** But that rule did not prevent the running of the interest during the receivership; and if, as a result of good fortune or good manage-

ment, the estate proved **sufficient to discharge the claims in full**, interest as well as principal should be paid."

That this is the correct interpretation of the general rule laid down by this Court in the two cases above referred to is clearly shown in the following decisions:

Pennsylvania Steel Co. v. New York City Ry. Co., 216 Fed. 472;
Huff v. Bidwell, 218 Fed. 10;
New York Trust Company et al. v. Detroit T. & I. Ry. Co., 251 Fed. 519;
Pintsch Compressing Co. v. Buffalo Gas Co., 280 Fed. 830, at page 844;
Mercantile Trust Co. v. Tennessee Central Railroad Company, 286 Fed. 425;
Peter A. Frasse & Co. v. Hartford Automotive Parts Co., 300 Fed. 876.

The rule in Missouri is the same as that announced by this Court (Van Frank v. Missouri Pacific R. R. Co., 89 Mo. Appeal Reports 460).

There is nothing in the certificate which would take this case out of the general rule and Judge Sanborn's decision supra, page 23, shows that in his opinion the facts of the case with which, as administrative judge he was familiar, brought it within the general rule. Attention is also called to the fact that in Judge Sanborn's opinion approving the offer he said:

> "The amounts of the claims of the unsecured creditors in the St. Louis & San Francisco Railway reorganization and in the Missouri Pacific Railroad reorganization were fixed and allowed, and securities

of the new company were distributed to them upon that basis (interest to date of the appointment of the Receiver and not later), and it is probable that this was the basis used in the reorganization of the Chicago, Rock Island & Pacific Railroad Company."

Conclusion.

For all the reasons above set out, we submit that all three questions certified by the Circuit Court of Appeals should be answered in the affirmative.

Respectfully submitted,

JOSEPH M. BRYSON,

Solicitor for Missouri-Kansas-Texas Railroad Company, Appellee.

ARTHUR H. VAN BRUNT and
JOSEPH M. BRYSON,

Solicitors for Francis F. Randolph and Hugo W. Blumenthal, Appellees.

EDWARD CORNELL,
CHARLES E. HOTCHKISS and
EDWARD C. ELIOT,

Solicitors for Central Union Trust Company of New York, as Trustee under Consolidated Mortgage, and as Trustee under Trust Agreement, Appellee.

GELLER, ROLSTON & BLANC and
NAGEL & KIRBY,
Solicitors for The Farmers' Loan and Trust Company, as Trustee under Refunding Mortgage, and as Trustee under St. Louis Division Mortgage, Appellees.

HORNBLOWER, MILLER & GARRISON and
CHARLES W. BATES,
Solicitors for The New York Trust Company, as Trustee under General Mortgage, Appellee.

BOYLE & PRIEST,
Solicitors for B. F. Edwards, as Trustee under General Mortgage, Appellee.

WHITE & CASE and
GEORGE H. WILLIAMS,
Solicitors for Bankers Trust Company, as Trustee under Second Mortgage, Appellee.

MASTEN & NICHOLS and
LEE W. HAGERMAN,
Solicitors for Columbia Trust Company (now Irving Bank-Columbia Trust Company), as Trustee under the First Mortgage of The Missouri, Kansas & Eastern Ry. Co., Appellee.

RICHARDS, SMYTH & CONWAY and
CHARLES A. HOUTS,
Solicitors for Central Union Trust Company of New York, as Trustee under Second Mortgage of M. K. & E. Railway Co., Appellee.

KING, LANE & TRAFFORD and
GEORGE C. HITCHCOCK,

Solicitors for Central Union Trust Company of New York, as Trustee under First Extension Mortgage, Appellee.

CHARLES P. WILLIAMS,

Solicitor for The Farmers' Loan and Trust Company, as Trustee under S. W. Coal & Improvement Company First Mortgage, Appellee.

JOSEPH M. BRYSON,
ALBERT RATHBONE,
ARTHUR H. VAN BRUNT,
NICHOLAS KELLEY,
EDWARD CORNELL,
EDWARD C. ELIOT,
H. C. MCCOLLOM,
EDWARD H. BLANC,
ALLEN C. ORRICK,
W. W. MILLER,
CHARLES W. BATES,
GEORGE H. WILLIAMS,
ROBERTS WALKER,
PERRY D. TRAFFORD,
GEORGE C. HITCHCOCK,
Of Counsel.

APPENDIX A.

The opinion delivered by Judge Sanborn in the case of North American Company v. St. Louis & San Francisco Railroad Company reads as follows:

> "The only real issue presented in the consideration of the motion to confirm this sale is whether or not the Reorganization Committee have presented a fair and timely offer of payment, or a fair and timely offer of participation in the reorganized company, through stocks, bonds or otherwise, as required by the eighteenth paragraph of the decree. In the consideration of that question the Court cannot divest itself of experience, nor of its knowledge of the course of proceedings in this receivership, and the relations of the lien holders, creditors and stockholders and the respective interests they hold. The Court cannot divest itself of knowledge of the operation of the railroad company, the income derived from the operation of the railroad, the amounts required during the three years when it has been in the hands of the Court to pay the necessary expenses of operation, and the amounts that would have been required to pay the interest upon the lien secured upon the property; nor can it divest itself of the knowledge which comes from an acquaintance with the earnings of the property while it has been operated as carefully as the Receivers were able to operate it, and as economically as they knew how to handle it. Looking back over the history of the receivership, it is certain that during the three years it has been operated by the Receiver it has not earned enough to pay the necessary expenses of operation

and the amounts that would have been required to pay interest on its liens if those amounts had been paid. And that knowledge stands against the estimates which have been presented now as to the value of this property when the time came to foreclose the mortgage and render the decree. The Court will not undertake to review the various arguments which have been made, or to state the terms of the offer, for you have all heard that and know it. The objections that are made to the offer are, briefly, these: That commissions to the amount of five millions of dollars have been provided for in the reorganization plan, which ought not to have been paid. Conceding that that may be so, it is not of sufficient importance in the mind of the Court to determine the question whether a fair and timely offer has been made to the creditors, that all the other considerations are given their proper weight. It is said that the offer is not an offer, that it is conditional, because there is a provision in it that disputed claims may be litigated. But it would not be just or righteous to require reorganization committees to pay claims that were uncertain in amount, or uncertain as to the rights upon which they are founded, and the Court is of the opinion that that provision will not be applied to claims that are just, or to claims whose amounts are determined, but the purpose of it was to give an opportunity to litigate those about which there was a real question of law or fact, and so far as these were concerned, it was not an unreasonable provision. Now, it is said that the value of this property was three hundred twenty-one millions of dollars, and that after everybody was provided for who had liens on or claims against this company,

down to the general creditors, there was an equity of ninety-one millions of dollars left, and that the equity ought to be applied to the payment of creditors before the stockholders should receive anything. That is an estimate, but the Court is clearly of the opinion that if the lien holders who foreclosed their mortgage upon this property had proceeded to a sale of the property under their rights, no one could have been found who would have paid enough to satisfy the bonded liens, and there would have been nothing left for either creditors or stockholders. It was, in the opinion of the Court, only by virtue of this reorganization scheme, whereby the stockholders would take hold and assist to reorganize the company, and to take these new securities, or a portion of them, that anything whatever could have been saved for the common creditors. They never could have bought this property, they never could have reorganized this company, they never could have purchased this property so as to give to themselves anything above the amount required to pay the bonded debt. So that this estimate of three hundred twenty-one millions and this equity of ninety or ninety-one millions, when it comes to an actual foreclosure of the mortgage and the handling of a big property like this, is more imaginary than real. It is said that larger payments have been made to some creditors than to others. It is difficult to perceive how that fact can determine the question whether or not this is a fair and timely offer. There is no objection that the Court can perceive to a reorganization committee, or anyone else, purchasing claims against an insolvent railroad company, for any price it sees fit to give, and paying some percentage to one creditor and a

larger or less percentage to another, and it seems to the Court that the fact that the banks have been paid a larger percentage than some others, and that small creditors under a hundred dollars have been paid a larger percentage than others, does not determine the question whether or not these protestants have received a fair and timely offer in settlement of their claims. Now, inasmuch as the Court is of the opinion and thinks that there is no doubt that these creditors would have received nothing whatever out of the foreclosure of this property, unless the Reorganization Committee had evolved a scheme or plan whereby this property could be distributed among stockholders and creditors, and would have lost everything, and, **inasmuch as under this offer each creditor is given a larger percentage of his claim in actual value than any stockholder received, the offer cannot be said to be unfair or untimely.** It is an advantage to the creditor to have such a plan or scheme, an advantage from which they derive about 25 per cent of their claims, where, if there had been no such plan or scheme, they would have received nothing. For these reasons the Court thinks the objections must be overruled and that the sale must be confirmed, and the order confirming the sale will be signed" (Transcript of record, p. 495).

No. 265

IN THE

Supreme Court of the United States

OCTOBER TERM, 1924 1925

KANSAS CITY TERMINAL RAILWAY COMPANY, *et al.*,

Petitioners,

vs.

CENTRAL UNION TRUST COMPANY OF NEW YORK, Trustee, *et al.*,

Respondents.

BRIEF OF RESPONDENTS IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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IN THE

Supreme Court of the United States

October Term, 1924.

KANSAS CITY TERMINAL RAILWAY COMPANY, *et al.*,
Petitioners,

vs.

CENTRAL UNION TRUST COMPANY OF NEW YORK,
Trustee, *et al.*,
Respondents.

BRIEF OF RESPONDENTS IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

Statement

Missouri, Kansas & Texas Railway Company (hereinafter called the Old Company) and eleven other railroad companies were parties to certain contracts (hereinafter collectively called the Terminal Contracts) giving to the Old Company and such other railroad companies the right to use for a period of two hundred years certain terminal facilities in Kansas City, Missouri, belonging to Kansas City Terminal Railway Company. The Petitioners in this case are Kansas City Terminal Railway Company, certain of the railroad companies which were parties to the Terminal Contracts, and the Trustees under the mortgage of Kansas City Terminal Railway Company. In the proceedings in the District Court of the United States for the

Eastern District of Missouri for the foreclosure of certain mortgages on the property of the Old Company, these Petitioners filed an intervening petition claiming, among other things, that the Terminal Contracts were entitled to priority in equity over the mortgages of the old Company in foreclosure, and that the District Court, in its final decree of foreclosure and sale, should require the purchasers of the property sold thereunder to assume the Terminal Contracts.

The District Court denied the prayer of the intervention, and entered its Final Decree, giving the purchasers of the property sold the right to disaffirm the Terminal Contracts. The petitioners thereupon appealed to the Circuit Court of Appeals for the Eighth Circuit. That Court in *Kansas City Terminal Railway Company, et al.* v. *Central Union Trust Company et al.*, 294 Fed. 32, unanimously affirmed said Final Decree on the ground that the Terminal Contracts were simply executory contracts, had no priority over the mortgages of the Old Company, were not binding on the purchasers at foreclosure sale and need not be assumed by such purchasers. A petition for rehearing was denied. Thereupon petition was made to this Court for a writ of certiorari, which was denied (264 U. S. 588). This earlier appeal of the Petitioners is hereinafter called for convenience the First Appeal.

In due course, petition was made to the District Court for confirmation of the sale of the property sold pursuant to said Final Decree to Missouri-Kansas-Texas Railroad Company (hereinafter called the New Company) pursuant to a Reorganization Plan filed with the District Court. Under this Reorganization Plan, in order to provide the money necessary for the reorganization, stockholders of the Old Company were given the right to purchase certain securities of the New Company. Unsecured creditors of the Old Company were offered certain securities of the New Company, without payment, and were given an alternative

right, if they should so elect, to purchase certain securities on better terms than those offered to stockholders. Petitioners appeared at the hearing on the petition for confirmation and objected to confirmation of the sale, on the ground that the offer made to creditors of the Old Company pursuant to said Reorganization Plan was not a fair and reasonable offer, or if fair and reasonable as to creditors in general, was not fair and reasonable as to them, because no offer could be fair and reasonable as to them except an offer to assume the Terminal Contracts. The District Court, after a full hearing, held that the offer was fair and reasonable as to creditors generally and as to the petitioners, and confirmed the sale. Thereupon the Petitioners appealed from the order confirming the sale to the Circuit Court of Appeals for the Eighth Circuit. This appeal is hereinafter called for convenience the Second Appeal. The Circuit Court of Appeals, after hearing argument, certified to this Court the following questions:

> "Question I. Is a plan of reorganization of a railway company sufficient as to unsecured creditors and binding upon them which does not give precedence to the entire claim of the creditor over any part or interest of a stockholder in the old company?
>
> Question II. Is such a plan fair and binding upon such creditors even though they be offered securities of the same grade as the stockholders, the difference being only in the greater amount offered the creditor, provided the court shall be of the opinion that the offer tenders to such creditor all that could reasonably be expected under all of the existing circumstances?
>
> Question III. Is such offer as to such creditors fair and binding if it consists only of the same grade of securities as offered the stockholders, the difference being that the right of the stockholder to participate is conditioned upon the payment of an assessment or the payment of a relatively greater as-

> sessment than that asked of such creditors, provided the court shall be of the opinion that the offer tenders to such creditor all that could reasonably be expected under all of the existing circumstances?"

The Petitioners are now requesting this Court to issue a writ of certiorari, bringing up to this Court the entire record of the Second Appeal.

The sole controversy in the Second Appeal is whether the offer made by the Reorganization Managers to unsecured creditors of the Old Company was a fair, reasonable and legal offer, that is (1) whether the offer was fair and reasonable on the basis of the *value* of securities offered to secured creditors, unsecured creditors and stockholders, respectively, in the light of all the facts of this case, and (2) whether, under the principle enunciated by this Court in *Northern Pacific Railroad Co.* v. *Boyd*, 228 U. S. 482, an offer to unsecured creditors must consist entirely of cash and/or of securities prior in rank to any securities offered or sold to stockholders. The first question is one primarily of fact, of *value*, and obviously, from the form of the questions certified to this Court, the Circuit Court of Appeals is prepared to answer it in the affirmative and does not require the instruction of this Court. The second question is a question of law, involving the *character* of the securities offered. This is the question which has been certified to this Court.

The Petitioners, however, attempted on the argument before the Circuit Court of Appeals, as they have attempted in their brief to this Court, to inject into the Second Appeal their claim, which was finally settled adversely to them on the First Appeal, that the Terminal Contracts are of such an unusual nature that they are prior to mortgage liens and must be assumed by purchasers at foreclosure sale. This contention is *res adjudicata* as between these parties, it having been finally settled in this case and be-

tween these parties by the decision of the Circuit Court of Appeals in the First Appeal, and by the refusal of this Court to grant a writ of certiorari in respect of that decision, as more fully set out under Point III below, and cannot now be reargued.

It may be mentioned in passing that the Petitioners have claimed that the offer of the Reorganization Managers to unsecured creditors was not made to them. The District Court expressly held that the offer was made to the Petitioners, and they do not seriously contend that this question is one with which this Court should concern itself. Obviously it is not. It may be stated, however, that not only were copies of the offer of the Reorganization Managers served on the Petitioners but the offer was expressly made to them in open court at the hearing on the petition for confirmation of sale.

POINT I.

There is in this case no question which, under the principles laid down by this Court, is a basis for the issuance of a writ of certiorari.

This Court has recently said, in *Magnum Co.* v. *Coty*, 262 U. S. 159, at page 163:

> "The jurisdiction to bring up cases by certiorari from the Circuit Courts of Appeals was given for two purposes, first to secure uniformity of decision between those courts in the nine circuits, and second, to bring up cases involving questions of importance which it is in the public interest to have decided by this Court of last resort";

Even more recently this Court, in *Biddle* v. *Lurisch*, 266 U. S. 173 (Preliminary Print, Number Two) (decided No-

vember 17, 1924), in dismissing a certificate sent up by the Circuit Court of Appeals, said:

> "The constantly increasing demands upon us make it highly important that only matters which are both substantial and in approved form should be presented."

Obviously, the Circuit Court of Appeals did not consider any question in this case, except those which it has certified, important enough to be brought to the attention of this Court and does not require the instructions of this Court on any other point. The Petitioners, however, are asking this Court to spend its valuable time in an examination of the elaborate and voluminous record in this case, prior to any decision by the Circuit Court of Appeals. Moreover, they base their claim to this Court's attention almost entirely on their claim of priority for the Terminal Contracts. That claim was finally settled adversely to them in the First Appeal, and this Court has already decided that it is not of sufficient public interest to justify the issuance of a writ of certiorari. *Kansas City Terminal Railway Company et al* v. *Central Union Trust Company of New York, Trustee, etc. et al*, 264 U. S. 588. The question is *res adjudicata*.

The two contentions on which the Petitioners base their claim are briefly discussed under Points II and III below. The Respondents believe, however, that it will be obvious to this Court from the preceding statement of facts that this case does not come within the tests laid down by this Court in the cases above referred to.

POINT II.

The fairness and reasonableness of the offer to unsecured creditors, on the basis of value, is not a question of public or general interest.

The Circuit Court of Appeals for the Eighth Circuit has, in effect, asked this Court to determine whether, under the doctrine of the *Boyd* case, the offer to creditors in this case is *legal*, that is, whether an offer to creditors in a reorganization, although fair and reasonable on the basis of value, must be held an unfair and unreasonable offer if it does not consist entirely of cash and/or of securities prior in rank to any securities offered to stockholders. This doubt in the minds of the Circuit Court of Appeals presumably arises from the reference to "preferred stock or income bonds" in the *Boyd* case. The question has never been decided by this Court. The Circuit Courts of Appeals which have considered the question have, so far as the respondents are advised, uniformly reached the conclusion that the proper test was the relative value, rather than the character, of the securities offered to creditors and stockholders. *Howard* v. *Maxwell Motor Company*, 269 Fed. 292 (especially page 294); affirmed 275 Fed. 53 (2nd Circuit); *Western Union Telegraph Company* v. *U. S. and Mexican Trust Company*, 221 Fed. 545, at p. 549 (8th Circuit); *Phipps* v. *Chicago, R. I. & P. Ry. Co.*, 284 Fed. 945, at p. 950 (8th Circuit).

The petitioners, however, ask this Court to pass on a further question, viz., whether the offer made to creditors in this particular case was fair and reasonable on the basis of the value of the securities offered. This question is of no public or general interest whatsoever. It is limited to this particular case and can be decided only on consideration of all the facts in this case. The decision of such a question would be of no value as a precedent or as a guide to the lower Federal courts, since every such question must be decided on the special facts of the case in which it arises.

It may be assumed from the questions certified by the Circuit Court of Appeals that that court has made up its mind that the offer to creditors in this case is fair and reasonable, on the basis of value. The fairness and reasonableness of the offer to creditors can only be determined by a consideration of all the evidence in these proceedings as well as the pleadings and orders and decrees made from time to time during the receivership. Among other things there must be taken into account (1) the value of the property reorganized; (2) the amount, if any, which creditors could have realized on their claims if it had not been possible, with the assistance of the stockholders and the money which they furnished, to put through a reorganization, and (3) the value of the securities offered to the secured creditors, the unsecured creditors and the stockholders, respectively. All the facts on which the decision must be based are peculiarly within the knowledge of the District Court which had charge of this property, through its Receiver, for seven years, and of the local Circuit Court of Appeals which was in close touch with the general situation.

For this Court to pass on this question would require it to make a detailed study of the history of the receivership and of the reorganization, and a detailed analysis not only of the value of the offer made to unsecured creditors, but also of the value of the offers made to secured creditors and of the rights accorded to stockholders. It is respectfully submitted that such study and analysis would be a waste of the valuable time of this Court, and, because of the difference in the facts of each case, the decision of this Court would not result in the creation of any precedent which would be a valuable guide to the lower courts or to reorganizers of corporations in the future.

The question of the legality of the offer, which has been certified by the Circuit Court of Appeals, can be decided by this Court without any examination of the record.

POINT III.

This Court has already decided that the claim of the Petitioners to special treatment for the Terminal Contracts is not a question in respect of which a writ of certiorari will be issued. The argument contained in Point II of the Petitioners' brief is merely an attempt to have this Court reconsider that decision.

As stated above, the basis of the First Appeal was the claim of the Petitioners that the Terminal Contracts were, by reason of the public interest in the maintenance of the union terminals at Kansas City, or for some reason, so sacrosanct that they were in effect prior to the mortgages of the Old Company, and must be assumed by purchasers at foreclosure sale. This Court long ago decided, in *Des Moines R. Co.* v. *Wabash Ry. Co.*, 135 U. S. 576, and in *Express Company* v. *Railroad Company*, 99 U. S. 191, that such contracts have no such priority but are merely ordinary executory contracts. This Court said in the *Des Moines* case, 135 U. S. 576, at page 582:

> "There is nothing * * * * in the nature of the contract which should make it one running with the land, or one chargeable upon the railroad, when by due course of law, or in any other mode, the property passed to other hands."

Following these decisions, the Circuit Court of Appeals, in the First Appeal, held that the Terminal Contracts fell into the class of ordinary executory contracts, that they had no priority over mortgages, did not run with the land, and need not be assumed by the purchaser at foreclosure sale.

These petitioners thereupon applied to this Court for a writ of certiorari, which was refused (264 U. S. 588).

In accordance with the principles laid down in *Magnum Co.* v. *Coty*, *supra*, this Court naturally refused certiorari in the First Appeal, since the questions involved therein had been settled by this Court in the *Des Moines* case and the *Express Company* case, *supra*. Moreover, there is no conflict among the decisions of the Circuit Courts of Appeal. (See for example *Baker* v. *Central Trust Co.*, 235 Fed. 17, 6th Circuit.)

Since there was no reason for certiorari in the First Appeal, there is no reason for certiorari here. As above stated, the Second Appeal involves only two questions, (1) the fairness and reasonableness of the offer to creditors, which has been considered under Point II and (2) the legality of the offer, which is now before this Court. The Petitioners are attempting to reopen the questions settled by the First Appeal by claiming for the Terminal Contracts some special sanctity which would require the obligees thereunder to receive in the reorganization an offer different from that made to all other creditors of the same class,—an offer to assume the Terminal Contracts. The Terminal Contracts were held in the First Appeal to be ordinary executory contracts, no different from other executory contracts, and the rights arising from a breach thereof are the ordinary rights of unsecured creditors. *This is the law of this case.* The contention here made by the petitioners is merely a restatement of their contention that the Terminal Contracts had priority over other executory contracts and over mortgage bondholders, which was finally decided against them in the First Appeal.

Obviously, if the Terminal Contracts are not prior to mortgages, or binding on a purchaser at foreclosure sale, they cannot be given such priority under the guise of an application of the principle of the *Boyd* case.

For the sake of completeness, brief reference may be made to some of the arguments brought forward by the Petitioners in their brief. They say that the Terminal Contracts might be specifically enforced. Even if they

could be specifically enforced against the Old Company, they cannot be specifically enforced against a receiver of the property of the Old Company, or against purchasers at foreclosure sale. *Des Moines R. Co.* v. *Wabash Ry. Co.*, *supra; Baker* v. *Central Trust Company*, *supra.* See also *Wiggins Ferry Co.* v. *Ohio & M. Ry. Co.*, 142 U. S. 396, 408; *Hoard* v. *Chesapeake & O. Ry.*, 123 U. S. 222. If the Petitioners have a right to have a court of equity enter a decree for the amount of damages to which they are entitled, this right is protected. They are now before a court of equity (District Court of the United States for the Eastern District of Missouri) on their intervening petition and that Court has referred to a master the question of ascertaining the damages, if any, to which they are entitled.

The Petitioners cite the cases of *Pierce* v. *United States*, 255 U. S. 398 and *Howard* v. *Maxwell Motor Co.*, 269 Fed. 292, 275 Fed. 53 as showing that offers made in reorganizations must be fair to the obligee of a particular contract.

If by this statement the Petitioners mean that different offers must be made to creditors under different kinds of executory contracts, neither these cases nor any others with which the Respondents are familiar enunciate any such principle. In the *Maxwell* case the Court held that a fair offer had not been made to the lessor under a broken lease, not because he had received only the same offer made to all other creditors, but because he had received no offer. The offer was limited to claims arising prior to a specific date, and the lessee took care not to make default under the lease until after that date had passed.

The *Pierce* case has nothing whatsoever to do with reorganizations. It simply held that the United States, as the creditor of a corporation, may pursue the assets of that corporation even after a voluntary distribution of such assets among stockholders.

The Petitioners also attempt again to make the point they unsuccessfully argued on the First Appeal, that public interest demands that the New Company continue to use these terminals, and that such public interest is sufficient to defeat the legal rights of mortgage bondholders. But this Court has already decided, on the First Appeal, that no important question of public or general interest is here involved. Nor is there anything substantial in the suggestion made in the brief of the Petitioners that the New Company should be required to assume the Terminal Contracts, on such terms as might be found to be equitable. It has been shown in these proceedings that the Terminal Contracts were grossly inequitable as to the Old Company. The New Company has, however, petitioned the Interstate Commerce Commission for authority to use the terminals or such parts thereof as it needs, on reasonable terms, and is now using the terminals pursuant to Service Order No. 40 of the Interstate Commerce Commission entered March 27, 1924 (I. C. C. Docket No. 15682) under the authority of paragraph 15 of Section 1 and paragraph 4 of Section 3 of the Interstate Commerce Act. That order permits the New Company to use the terminals on the terms specified in the Terminal Contracts, pending the decision of the Commission on further hearing as to what would be fair and reasonable terms. A copy of said Service Order No. 40 is Exhibit A hereto. The New Company is using the terminals and has already done, in substance, what the Petitioners suggest that this Court should order it to do. No question of public interest arises.

Obviously, the Circuit Court of Appeals was right when it said in the First Appeal (294 Fed. 32 at page 39):

> "It requires no second sight or prophetic vision to induce a profound suspicion that the itching question here is not whether the New Company shall stay in, but the terms and conditions on which it shall stay in. It follows that the remoteness of injury to the public, if not the utter impossibility of it, renders very serious consideration of the question unnecessary."

CONCLUSION.

The respondents respectfully submit that this Court should deny the application.

Respectfully submitted.

JOSEPH M. BRYSON,
Solicitor for Missouri-Kansas-Texas Railroad Company, Appellee.

ARTHUR H. VANBRUNT, and JOSEPH M. BRYSON,
Solicitors for Francis F. Randolph and Hugo W. Blumenthal, Appellees.

EDWARD CORNELL, CHARLES E. HOTCHKISS and EDWARD C. ELIOT,
Solicitors for Central Union Trust Company of New York, as Trustee under Consolidated Mortgage, and as Trustee under Trust Agreement, Appellee.

GELLER, ROLSTON & BLANC, and NAGEL & KIRBY,
Solicitors for The Farmers' Loan and Trust Company, as Trustee under Refunding Mortgage, and as Trustee under St. Louis Division Mortgage, Appellees.

HORNBLOWER, MILLER & GARRISON, and CHARLES W. BATES,
Solicitors for The New York Trust Company, as Trustee under General Mortgage, Appellee.

BOYLE & PRIEST,
Solicitors for B. F. Edwards, as Trustee under General Mortgage, Appellee.

WHITE & CASE, and GEORGE H. WILLIAMS,
Solicitors for Bankers Trust Company, as Trustee under Second Mortgage, Appellee.

MASTEN & NICHOLS and LEE W. HAGERMAN,
Solicitors for Columbia Trust Company (now Irving Bank-Columbia Trust Company), as Trustee under the First Mortgage of The Missouri, Kansas & Eastern Ry. Co., Appellee.

RICHARDS, SMYTH & CONWAY, and CHARLES A. HOUTS,
Solicitors for Central Union Trust Company of New York, as Trustee under Second Mortgage of M. K. & E. Railway Co., Appellee.

KING, LANE & TRAFFORD, and GEORGE C. HITCHCOCK,
Solicitors for Central Union Trust Company of New York, as Trustee under First Extension Mortgage, Appellee.

CHARLES P. WILLIAMS,
Solicitor for The Farmers' Loan & Trust Company, as Trustee under S. W. Coal & Improvement Company First Mortgage, Appellee.

JOSEPH M. BRYSON,

ALBERT RATHBONE,
ARTHUR H. VANBRUNT,
NICHOLAS KELLEY,

EDWARD CORNELL,
EDWARD C. ELIOT,
H. C. MCCOLLOM,

EDWARD H. BLANC,
ALLEN C. ORRICK,

W. W. MILLER,
CHARLES W. BATES,

GEORGE H. WILLIAMS,
ROBERTS WALKER,

PERRY D. TRAFFORD,
GEORGE C. HITCHCOCK,
of Counsel.

Exhibit A.

SERVICE ORDER No. 40.

At a Session of the INTERSTATE COMMERCE COMMISSION, DIVISION 5, held at its office in Washington, D. C., on the 27th day of March, A. D. 1924.

The subject of the joint or common use of terminals, including main line track or tracks for reasonable distances outside of such terminals, being under consideration, and

It appearing that a controversy exists between the Missouri-Kansas-Texas Railroad Company and the Kansas City Terminal Railway Company, hereinafter termed the petitioner and the Terminal Company, respectively, over the terms under which the petitioner shall be permitted to use the union passenger station and certain of the passenger and freight terminal facilities at Kansas City, Mo., including main line track or tracks outside of such terminals, lying within and included in what are known as zones, numbers 5, 6, 6a, 7, 8, 9, 10, 11, 12, 14, 15, 16, 17, 18, 19, 33, 33a, 34, 35, 36, 38, 39, 40, 40½, 41, 42, 43, 43½, 44, 44½, 45, 46, 47, 48, 49, 50, 53, 60, 61, 62, 63, 64 and 65, owned and operated by the Terminal Company, which has been brought to the attention of the Commission by a formal complaint filed by said petitioner under No. 15682, and

It further appearing from the allegations of said complaint and by certain correspondence had with petitioner subsequent thereto, that the petitioner has been and is now using said union passenger station and certain other of the terminal facilities of the Terminal Company and is making payment to said Terminal Company therefor in accordance with the terms of a certain agreement entered into by and between the Terminal Company, on the

one hand, and the Missouri, Kansas & Texas Railway Company, hereinafter termed the old company, and other proprietary companies of the Terminal Company, on the other hand, dated June 12, 1909, known by the parties thereto as the Operating Agreement and Supplemental Agreement thereto, dated January 24, 1910, and

It further appearing that the District Court of the United States for the Eastern District of Missouri, Eastern Division, in a proceeding brought before it involving inter alia, the operating agreement in question held that the petitioner, which acquired at foreclosure sale the property of the old company, with certain exceptions not here pertinent, was not required to adopt the operating agreements of the old company, and

It further appearing that the decision of the District Court was affirmed by the United States Circuit Court of Appeals for the Eighth Circuit, and

It further appearing that the Supreme Court of the United States on March 10, 1924, denied the petition of the Terminal Company, et al, for a writ of certiorari, thus making the decision of the United States Circuit Court of Appeals for the Eighth Circuit, final, and

It further appearing that the petitioner has elected not to become a proprietary company of the Terminal Company, and has determined not to adopt the agreements between the Terminal Company and the old company, but desires to use said union passenger station and certain of the other terminal facilities of the Terminal Company upon such terms and for such compensation as the Commission may find to be reasonable, and

It further appearing that the petitioner has notified the Terminal Company that as authorized by the final decree of foreclosure directing the sale of the properties of the Missouri, Kansas & Texas Railway Company it will on or before March 31, 1924, file in the office of the clerk of the District Court of the United States for the Eastern

District of Missouri, Eastern Division, its election to refuse to adopt or continue in force said operating agreement hereinbefore referred to, and

It further appearing that the petitioner has notified the Terminal Company of its desire to enter into an agreement with the Terminal Company for the use of said union passenger station and other terminal facilities including main line tracks as more fully hereinbefore set forth upon what is commonly known as the user basis, and

It further appearing that the Terminal Company has declined to negotiate an agreement upon such terms, and has notified the petitioner that it can only continue to use said union passenger station and other terminal facilities according to the terms of said operating agreement hereinbefore referred to, and

It further appearing that by reason of failure of the parties to agree as to the terms of compensation to be paid for the use of said union passenger station and other terminal facilities the petitioner has been notified by the Terminal Company that it will not be permitted to use said union passenger station and other terminal facilities on and after April 1, 1924, except upon the terms of said operating agreement,

And it further appearing that by reason of said notice of refusal of the Terminal Company to permit the petitioner to use said union passenger station and other terminal facilities except under the terms of the operating agreement entered into by the old company, and which the petitioner is not willing to agree to, an emergency is created which requires the immediate action of the Commission,

And it further appearing that the petitioner in order to adequately secure compensation to the Terminal Company is willing, pending hearing by the Commission, to observe the terms and provisions of the operating agreement and make the payments therein provided without

prejudice to its own rights or those of the Terminal Company,

Therefore, in order best to promote the service in the interest of the public and the commerce of the people, and in order that the constant flow of interstate commerce may not be interfered with,

It is ordered and directed, effective April 1, 1924, and until the further order of the Commission in the premises, that the Kansas City Terminal Railway Company be, and the same is hereby, notified and required to permit the Missouri-Kansas-Texas Railroad Company to use the union passenger station and other terminal facilities at Kansas City, Mo., including main line track or tracks for a reasonable distance outside such terminals, lying within and included in what are known as zones, numbers 5, 6, 6a, 7, 8, 9, 10, 11, 12, 14, 15, 16, 17, 18, 19, 33, 33a, 34, 35, 36, 38, 39, 40, 40½, 41, 42, 43, 43½, 44, 44½, 45, 46, 47, 48, 49, 50, 53, 60, 61, 62, 63, 64 and 65, upon the terms and provisions of said operating agreement of June 12, 1909, and supplemental agreement of January 24, 1910, and that in order that the Kansas City Terminal Railway Company may be adequately secured as to compensation, the Missouri-Kansas-Texas Railroad Company during such period shall pay the compensation provided for in said operating agreement and supplemental agreement.

It is further ordered that such payments to be made by the Missouri-Kansas-Texas Railroad Company shall not be the final measure of the compensation ultimately to be paid for the period while this emergency order is in effect, but the total compensation ultimately to be paid for such period shall be upon such terms as the carriers may agree upon, or in the event of their disagreement, as the Commission may after subsequent hearing find to be just and reasonable.

And it is further ordered that copy of this order be served upon the

Missouri-Kansas-Texas Railroad Company,
Kansas City Terminal Railway Company,
The Atchison, Topeka & Santa Fe Railway Company,
Chicago, Burlington & Quincy Railroad Company,
Chicago, Great Western Railroad Company,
Chicago, Milwaukee & St. Paul Railroad,
St. Louis-San Francisco Railway Company,
Wabash Railway Company,
Missouri Pacific Railroad Company,
Union Pacific Railroad Company,
The Chicago, Rock Island & Pacific Railway Company,
The Chicago & Alton Railroad Company and William W. Wheelock and William G. Bierd, Receivers thereof,
The Kansas City Southern Railway Company,

and that notice of this order be given to the general public by depositing a copy hereof in the office of the Secretary of the Commission at Washington, D. C.

By the Commission, Division 5:

[SEAL]

GEORGE B. MCGINTY,
Secretary.

EXHIBIT B.

UNITED STATES CIRCUIT COURT OF APPEALS,
EIGHTH CIRCUIT.

No. 6457.

KANSAS CITY TERMINAL RAILWAY COMPANY ET AL.,
Appellants,

vs.

CENTRAL UNION TRUST COMPANY OF NEW YORK ET AL.,
Appellees.

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN DISTRICT OF MISSOURI.

Amended Certificate—Filed April 25, 1925.

This amended certificate is presented, in lieu of the certificate heretofore filed, in order that certain additional facts (deemed by the parties and this court of use in determining the questions herein submitted) might be brought to the attention of the court.

The United States Circuit Court of Appeals for the Eighth Circuit hereby certifies that a record on an appeal now pending before it discloses the following:

The Kansas City Terminal Railway Company and others filed an intervening petition in the receivership proceedings of the Missouri, Kansas & Texas Railway Company. That intervention sought to attach the obligations of passenger terminal contracts to the property in such a way that the obligations of these contracts would be either a lien on the property prior to all mortgage obligations or would follow the property into the hands of any purchaser under foreclosure of the mortgages. It was determined by the district

court and affirmed by this court (294 Fed. 32) that these terminal contracts were ordinary executory contracts entered into by the Missouri, Kansas & Texas Railway Company as aids to its operation.

Thereafter, the property in receivership was sold under foreclosure. The purchase was in pursuance of a reorganization plan. This plan involved lien holders, unsecured creditors and stockholders. In so far as the plan affects lien holders it is not involved in this appeal. The points raised on this appeal relate to the fairness of the offer to these interveners which were classed as unsecured creditors. This plan was not submitted to the court but the offer to unsecured creditors, as contained therein, was submitted and approved. Their claim is that the stockholders were unduly preferred in this reorganization plan.

By the reorganization plan the new company was to have four classes of securities as follows:

Prior Lien Mortgage Bonds (authorized issue $250,000,000),

Cumulative Adjustment Mortgage Bonds (authorized issue $100,000,000) which were income bonds secured by mortgage as to principal, Preferred Stock (authorized issue $200,000,000),

Common Stock without par value (authorized issue 2,500,000 shares).

Of the above securities, certain amounts of each were reserved for future use by the new company. Of the prior lien bonds provided for distribution in the plan, some bore interest at four per cent, some at five per cent and some at six per cent respectively.

Under the reorganization plan new securities were offered to the holders of seventeen separate issues of outstanding bonds of the Missouri, Kansas & Texas Railway Company and its various subsidiary companies secured by mortgage and of one issue of notes secured by the pledge of mortgage bonds. In some cases, but not in all, cash was offered to the holders of these secured claims in addition to new

securities. In all cases the par amount of the new securities offered (taking the new non par value common stock at $100 per share) plus the cash offered, if any, equalled, and in no case did it exceed, the principal amount of the old outstanding securities in respect of which the offer was made plus the unpaid interest thereon up to January 1, 1922.

Of said eighteen outstanding issues

Five issues were offered only New Prior Lien Bonds and cash,

One issue was offered only New Prior Lien Bonds,

Five issues were offered only New Prior Lien Bonds and New Adjustment Bonds,

Three issues were offered only New Prior Lien Bonds, New Adjustment Bonds and New Preferred Stock,

One issue was offered only New Adjustment Bonds and New Preferred Stock,

Three issues were offered only, New Adjustment Bonds, New Preferred Stock and New Common Stock,

In all cases the New Prior Lien Bonds and the New Adjustment Bonds (whether offered to secured creditors, unsecured creditors or stockholders) were to bear interest from January 1, 1922.

In so far as the re-organization plan affected stockholders and unsecured creditors its provisions were substantially as follows: (1) Preferred stockholders were entitled to receive $14 in Prior Lien Bonds (bearing six per cent interest), $6 in Adjustment Bonds and one share of Common Stock in the new company upon payment of $20 for each share of stock of the par value of $100 held in the old company; (2) Common stockholders were entitled to receive $17.50 in Prior Lien Mortgage Bonds (bearing six per cent interest), $7.50 in Adjustment Bonds and one share of Common Stock upon payment of $25 for each share of stock of the par value of $100 held in the old company; (3) Unsecured creditors were given the choice of two plans: (*a*) one-third

of a share of Preferred Stock of the par value of $100 and two-thirds of a share of Common Stock without par value for each $100 of the aggregate amount of the claim, including interest to January 1, 1922, whereas the receiver was appointed and took possession of the property on September 27, 1915, the foreclosure decree was entered on June 30, 1922, the offer to creditors was dated July 15, 1922, the foreclosure sale was had on December 13, 1922, the order confirming the sale was entered February 9, 1923, and the order approving the Master's deed conveying the property to the new company was entered on March 10, 1923; (*b*) $14 in Prior Lien Mortgage six per cent bonds, $6 in Adjustment Mortgage Bonds and one share of Common Stock upon payment of $18 for each $100 of said claim.

A claim made by appellants here is that certain decisions of the Supreme Court of the United States (Northern Pacific Railway Company *v.* Boyd, 228 U. S. 482; Louisville Trust Company *v.* Louisville Railway Company, 174 U. S. 674) require that an offer in a re-organization plan, in order to be a fair and binding offer upon the creditor must be one which will preserve "to the creditor, his relative priority over the stockholder. It is not sufficient that he should get a little more than the stockholder. His entire claim must take precedence over any part of the interest of a stockholder. It is not sufficient that he be offered securities of the same grade as the stockholder but a trifle more in amount, or that the stockholder's right to participate be conditioned upon the payment of an assessment."

It is further certified that the following questions of law arise from this record and are presented, the decision of which is indispensable to a determination of the case. To the end that this court may properly discharge its duty it desires the instruction of the Supreme Court upon them.

Question I. Is a plan of re-organization of a railway company sufficient as to unsecured creditors and binding upon them which does not give precedence to the entire claim of the creditor over any part or interest of a stockholder in the old company?

Question II. Is such a plan fair and binding upon such creditors even though they be offered securities of the same grade as the stockholders, the difference being only in the greater amount offered the creditor, provided the court shall be of the opinion that the offer tenders to such creditor all that could reasonably be expected under all of the existing circumstances?

Question III. Is such offer as to such creditors fair and binding if it consists only of the same grade of securiites as offered the stockholders, the difference being that the right of the stockholder to participate is conditioned upon the payment of an assessment or the payment of a relatively greater assessment than that asked of such creditors, provided the court shall be of the opinion that the offer tenders to such creditor all that could reasonably be expected under all of the existing circumstances?

KIMBROUGH STONE,
United States Circuit Judge.
WILLIAM S. KENYON,
United States Circuit Judge.
C. B. FARIS,
United States Circuit Judge.

Being the Judges who sat in the Circuit Court of Appeals, on the hearing of the case.

UNITED STATES CIRCUIT COURT OF APPEALS,
EIGHTH CIRCUIT.

I, E. E. Koch, Clerk of the United States Circuit Court of Appeals for the Eighth Circuit, do hereby certify that the foregoing Amended Certificate in the case of Kansas City Terminal Railway Company et al., appellants, *vs.* Central Union Trust Company of New York et al., appellees, No. 6457, was duly filed and entered of record in my office by order of said Court, and as directed by said Court, the said certificate is by me transmitted to the Supreme Court of the United States for its action thereon.

In testimony whereof, I hereunto subscribe my name and affix the seal of the United States Circuit Court of Appeals for the Eighth Circuit, at office in the City of St. Louis, Missouri, this twenty-third day of April, A. D. 1925.

[SEAL.] E. E. KOCH,
Clerk of the United States Circuit Court
of Appeals for the Eighth Circuit.

Endorsed: U. S. Circuit Court of Appeals, Eighth Circuit. No. 6457. Kansas City Terminal Railway Company et al., appellants, *vs.* Central Union Trust Company of New York et al. Amended Certificate of Questions to the Supreme Court of the United States. Filed April 23, 1925. E. E. Koch, clerk.

SUPREME COURT OF THE UNITED STATES.

No. 265.—October Term, 1925.

Kansas City Terminal Railway Company et al., *vs.* Central Union Trust Company of New York et al.	On Certificate from the United States Circuit Court of Appeals for the Eighth Circuit.

[June 1, 1926.]

Mr. Justice McReynolds delivered the opinion of the Court.

This cause is here on certificate from the United States Circuit Court of Appeals, Eighth Circuit. Jud. Code § 239. The relevant facts and the submitted questions follow.

In a proceeding by creditors, the United States District Court, Eastern District of Missouri, appointed a receiver for the Missouri, Kansas & Texas Railway Company. Appellees asked foreclosure of liens upon the whole property, and procured an order of sale. According to a plan for purchase and reorganization, with definite offers to lien creditors, unsecured creditors and stockholders, Blumenthal and another bid in the assets and then assigned the rights so acquired to the Missouri-Kansas-Texas Railroad Company, a newly-organized Missouri corporation.

Pending entry of the final decree, appellants asserted preferential rights. These were denied, and they were held to be unsecured contract creditors. *Kansas City Terminal Ry. Co.* v. *Central Union Trust Co.*, 294 Fed. 32. Thereupon, they challenged the reorganization plan as unfair to them and unduly preferential to stockholders of the insolvent corporation. The trial court overruled their objection; the matter went to the Circuit Court of Appeals, and it has asked for instruction.

The reorganization scheme required the issuance of four classes of securities by the new company—

(1) Prior lien mortgage bonds (authorized, $250,000,000);

(2) Cumulative adjustment, or income, bonds (authorized, $100,000,000), secured by mortgage as to principal;

(3) Preferred stock (authorized, $200,000,000);
(4) Common stock, without par value (authorized, 2,500,000 shares).

Specified amounts of each of these were reserved for future use by the new company. Some of the prior lien bonds bore interest at four, some at five and some at six per cent.

New securities were offered to the holders of seventeen separate issues of outstanding bonds of the old company and its various subsidiaries, secured by mortgage, and one issue of notes, secured by the pledge of mortgage bonds. In some cases, but not all, cash was offered to holders of these secured claims in addition to the new securities. Always the par amount of the new securities offered (taking the new non-par-value common stock at $100 per share) plus the cash offered, if any, equalled, but never exceeded, the principal amount of the old securities, in respect of which the offer was made, plus interest to January 1, 1922.

Of these eighteen outstanding issues, five were offered new prior lien bonds and cash; one was offered new prior lien bonds; five were offered new prior lien bonds and new adjustment bonds; three were offered new prior lien bonds, new adjustment bonds and new preferred stock; one was offered new adjustment bonds and new preferred stock; three were offered new adjustment bonds, new preferred stock and new common stock.

In all cases the new prior lien bonds and the new adjustment bonds (whether offered to secured creditors, unsecured creditors or stockholders) were to bear interest from January 1, 1922.

As to stockholders and unsecured creditors, it was provided—(1) Preferred stockholders might receive $14 in prior lien bonds (bearing six per cent.), $6 in adjustment bonds and one share of common stock in the new company, upon payment of $20 for each $100 share of old stock. (2) Common stockholders might receive $17.50 in six per cent. prior lien mortgage bonds, $7.50 in adjustment bonds and one share of common stock, upon payment of $25 for each $100 share of old stock. (3) Unsecured creditors were given the choice of two plans: (a) one-third of a share of preferred stock, $100 par value, and two-thirds of a share of common stock without par value, for each $100 of their claims, plus interest to January 1, 1922, (whereas the receiver was appointed and took possession of the property September 27, 1915, foreclosure decree

was entered June 30, 1922, offer to creditors was dated July 15, 1922, foreclosure sale was had December 13, 1922, order confirming the sale was entered February 9, 1923, and order approving the master's deed conveying the property to the new company was entered on March 10, 1923); (b) $14 in prior lien mortgage six per cent. bonds, $6 in adjustment mortgage bonds and one share of common stock, upon payment of $18 for each $100 of their claims.

Appellants maintained below that *Northern Pacific Railway Co.* v. *Boyd*, 228 U. S. 482, and *Louisville Trust Co.* v. *Louisville Railway Co.*, 174 U. S. 674, require that an offer in a reorganization plan, in order to be fair and binding upon him, must preserve "to the creditor his relative priority over the stockholder. It is not sufficient that he should get a little more than the stockholder. His entire claim must take precedence over any part of the interest of a stockholder. It is not sufficient that he be offered securities of the same grade as the stockholder but a trifle more in amount, or that the stockholder's right to participate be conditioned upon the payment of an assessment."

The questions—

I. Is a plan of reorganization of a railway company sufficient as to unsecured creditors and binding upon them which does not give precedence to the entire claim of the creditor over any part or interest of a stockholder in the old company?

II. Is such a plan fair and binding upon such creditors even though they be offered securities of the same grade as the stockholders, the difference being only in the greater amount offered the creditors, provided the court shall be of the opinion that the offer tenders to such creditors all that could reasonably be expected under all of the existing circumstances?

III. Is such offer as to such creditors fair and binding if it consists only of the same grade of securities as offered the stockholders, the difference being that the right of the stockholders to participate is conditioned upon the payment of an assessment or the payment of a relatively greater assessment than that asked of such creditors, provided the court shall be of the opinion that the offer tenders to such creditor all that

could reasonably be expected under all of the existing circumstances?

These questions lack precision, and the accompanying statement of facts fails to reveal the detail of the situation with desirable clearness. There is nothing to show the amount or character of the insolvent company's outstanding securities, or the amount of the unsecured indebtedness, or the probable value of the equity in the property beyond secured debts, or the amount of money deemed necessary to insure successful operation of the new company. The questions, therefore, must be defined and answered with certain qualifications.

Chicago, etc., Railroad Co. v. *Howard*, 7 Wall. 392; *Louisville Trust Co.* v. *Louisville Railway Co.*, 174 U. S. 674; and *Northern Pacific Railway Co.* v. *Boyd*, 228 U. S. 482, gave much consideration to the general principles which must control the present cause. These were applied in *Kansas City, etc., Railway Co.* v. *Guardian Trust Co.*, 240 U. S. 166, and *Pierce* v. *United States*, 255 U. S. 398.

We accept those opinions as authoritative; and it now may be announced as settled doctrine, that where the value of corporate property to be sold under foreclosure is so great as to render cooperation between bondholders and stockholders essential in order to secure a bidder and prevent undue sacrifice of their interests they may enter into a fair and open arrangement to that end. But "no such proceedings can be rightfully carried to consummation which recognize and preserve any interest in the stockholders without also recognizing and preserving the interests, not merely of the mortgagee, but of every creditor of the corporation. In other words, if the bondholder wishes to foreclose and exclude inferior lienholders or general unsecured creditors and stockholders he may do so, but a foreclosure which attempts to preserve any interest or right of the mortgagor in the property after the sale must necessarily secure and preserve the prior rights of general creditors thereof. This is based upon the familiar rule that the stockholder's interest in the property is subordinate to the rights of creditors; first of secured and then of unsecured creditors. And any arrangement of the parties by which the subordinate rights and interests of the stockholders are attempted to be secured at the expense of the prior rights of either class of creditors comes

within judicial denunciation." *Louisville Trust Co.* v. *Louisville Railway Co.*, pp. 683, 684.

This doctrine is the "fixed principle" according to which *Northern Pacific Railway Co.* v. *Boyd* (p. 507), declares the character of reorganization agreements must be determined; and to it there should be rigid adherence. But, as that opinion states, this does not require the impossible and make it necessary always to pay unsecured creditors in cash before stockholders may retain any interest whatever in the reorganized company. By way of illustration it further pointed out, that such creditors can be protected "by the issuance, on equitable terms, of income bonds or preferred stock." And we now add that, when necessary, they may be protected through other arrangements which distinctly recognize their equitable right to be preferred to stockholders against the full value of all property belonging to the debtor corporation, and afford each of them fair opportunity, measured by the existing circumstances, to avail himself of this right.

Unsecured creditors of insolvent corporations are entitled to the benefit of the values which remain after lienholders are satisfied, whether this is present or prospective, for dividends or only for purposes of control. But reasonable adjustments should be encouraged. Practically, it is impossible to sell the property of a great railroad for cash; and, generally, the interests of all parties, including the public, are best served by cooperation between bondholders and stockholders. If creditors decline a fair offer based upon the principles above stated, they are left to protect themselves. After such refusal they cannot attack the reorganization in a court of equity. *Northern Pacific Railway Co.* v. *Boyd*, p. 508.

Question I, if interpreted strictly and according to the ordinary meaning of the words employed, must be answered in the negative. We assume that to "give precedence" implies recognition of superior importance. As above stated, to the extent of their debts creditors are entitled to priority over stockholders against all the property of an insolvent corporation. But it does not follow that in every reorganization the securities offered to general creditors must be superior in rank or grade to any which stockholders may obtain. It is not impossible to accord to the creditor his superior rights in other ways. Generally, additional funds will be essential to the

success of the undertaking, and it may be impossible to obtain them unless stockholders are permitted to contribute and retain an interest sufficiently valuable to move them. In such or similar cases the chancellor may exercise an informed discretion concerning the practical adjustment of the several rights.

Question II is answered in the affirmative, with the qualifications which follow. The primary right of unsecured creditors to the assets of an insolvent corporation remaining after lienholders are satisfied, must be adequately protected; and to each one of them there must be given such opportunity as the circumstances permit to secure the full enjoyment of this preference.

Question III is also answered in the affirmative, subject to the following qualification. No offer is fair which does not recognize the prior rights of creditors, as above pointed out; but circumstances may justify an offer of different amounts of the same grade of securities to both creditors and stockholders. Whenever assessments are demanded, they must be adjusted with the purpose of according to the creditor his full right of priority against the corporate assets, so far as possible in the existing circumstances.

A true copy.

Test:

Clerk, Supreme Court, U. S.